

United States
Circuit Court of Appeals
For the Ninth Circuit.

MOHAWK PETROLEUM COMPANY, a California corporation, EDWIN V. McKENZIE, as Executor of the Estate of Alfred L. Marsten, deceased, EDWIN V. McKENZIE, ALFRED L. MARSTEN, JR., and LEWIS A. MARSTEN,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Transcript of the Record

Upon Petition to Review Decisions of the Tax Court
of the United States

FILED

MAR 19 1943

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INDEX

[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

	Page
Answer:	
#105967	31
#105968	34
#105969	38
#105970	42
#105971	46
Appearances:	
#105967	1
#105968	3
#105969	4
#105970	5
#105971	6
Certificate of Clerk	106
Decision:	
#105967	84
#105968	85
#105969	86
#105970	87
#105971	88

Index	Page
Designation of Record (CCA)	108
Docket Entries:	
#105967	1
#105968	3
#105969	4
#105970	5
#105971	6
Opinion (All Causes)	67
Petition for Redetermination of Deficiency	
(#105967)	7
Exhibit A—Notice of Deficiency	13
#105968	33
#105969	37
#105970	41
#105971	45
Petition for Review and Assignments of Error	
(All Causes)	90
Notice of Filing	102
Praecipe	104
Notice of Filing	105
Statement of Points and Designation of Record	
(CCA)	108

Index	Page
Stipulation Designating Portions of the Record to be Printed (CCA)	110
Stipulation of Facts (#105967)	49
Exhibit A — Statement of Red Ribbon Ranch Lease—Analysis of Net Capital- ized Cost of Well Equipment Subject to Depreciation, etc.	59
Transcript of Hearing (All Causes)	63

APPEARANCES

For Taxpayer:

FRED H. BROWN, C.P.A.

R. KEMP SLAUGHTER, ESQ.,

For Comm'r.:

T. M. MATHER, ESQ.

Docket No. 105967

MOHAWK PETROLEUM COMPANY,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DOCKET ENTRIES

1940

Dec. 24—Petition received and filed. Taxpayer notified. Fee paid.

“ 26—Copy of petition served on General Counsel.

1941

Jan. 28—Answer filed by General Counsel.

1941

Jan. 28—Request for hearing in San Francisco filed by General Counsel.
“ 31—Notice issued placing proceeding on San Francisco, Cal. calendar. Service of answer and request made.

1942

Feb. 25—Hearing set March 23, 1942 at San Francisco, Calif.
Mar. 25—Hearing had before Mr. Arnold on merits. Submitted. Motion to consolidate dockets 105967, 68, 69, 70 and 71 granted. Stipulation of facts filed. Briefs due May 9, 1942—replies June 9, 1942.
Apr. 4—Transcript of hearing of 3/25/42 filed.
May 7—Brief filed by taxpayer.
“ 9—Brief filed by General Counsel.
“ 11—Copy of brief served on General Counsel.
Jun. 9—Reply brief filed by taxpayer. 6/9/42 copy served.
Oct. 30—Opinion rendered, Arnold, Div. 12. Decision will be entered for the respondent. 11/3/42 copy served.
Nov. 4—Decision entered, Arnold. Div. 12.

1943

Jan. 29—Supersedeas bond in the amount of \$33, ... 190.50 approved and ordered filed.
“ 29—Petition for review by U. S. Circuit Court of Appeals, 9th Circuit, with assignments of error filed by taxpayer.
“ 29—Proof of service filed by taxpayer.

1943

Jan. 29—Praecipe for record filed by taxpayer.
“ 29—Notice of filing praecipe for record with
proof of service thereon, filed by taxpayer.
Agreed to.
Feb. 6—Notice of appearance of R. Kemp Slaughter as counsel for taxpayer filed. [1*]

APPEARANCES

For Taxpayer:

FRED H. BROWN, C.P.A.
R. KEMP SLAUGHTER, ESQ.,

For Comm'r.:

T. M. MATHER, ESQ.

Docket No. 105968

ALFRED L. MARSTEN, Jr.,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DOCKET ENTRIES

(Printer's Note: Docket Entries are the same as listed in Docket No. 105967.) [2]

*Page numbering appearing at top of page of original certified Transcript of Record.

APPEARANCES

For Taxpayer:

FRED H. BROWN, C.P.A.

R. KEMP SLAUGHTER, ESQ.,

For Comm'r.:

T. M. MATHER, ESQ.

Docket No. 105969

LEWIS A. MARSTEN,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DOCKET ENTRIES

(Printer's Note: Docket Entries are the same as listed in Docket No. 105967.) [3]

APPEARANCES

For Taxpayer:

FRED H. BROWN, C.P.A.

R. KEMP SLAUGHTER, ESQ.,

For Comm'r.:

T. M. MATHER, ESQ.

Docket No. 105970

EDWIN V. MCKENZIE,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DOCKET ENTRIES

(Printer's Note: Docket Entries are the same as listed in Docket No. 105967.) [4]

APPEARANCES

For Taxpayer:

FRED H. BROWN, C.P.A.

R. KEMP SLAUGHTER, ESQ.,

For Comm'r.:

T. M. MATHER, ESQ.

Docket No. 105971

ESTATE OF ALFRED L. MARSTEN, Dec'd.

EDWIN V. McKENZIE, Executor,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DOCKET ENTRIES

(Printer's Note: Docket Entries are the same as listed in Docket No. 105967.) [5]

United States Board of Tax Appeals

Docket No. 105967

MOHAWK PETROLEUM COMPANY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION

The above named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (Bureau symbols—San Francisco Division IRA:90-D DCE C:TS:PD SF:CCG) dated October 4, 1940 and as a basis of its proceeding alleges as follows:

(1) The petitioner is a corporation duly organized and existing under and by virtue of the laws of the State of California and its address is 405 Montgomery Street, San Francisco, California. The returns for the period here involved were filed with the Collector of United States Internal Revenue for the First District of California.

(2) The notice of deficiency (a copy of which is attached marked Exhibit A) was mailed to the petitioner on October 4, 1940.

(3) The taxes in controversy are income taxes for the fiscal years ended September 30, 1936 and Sep-

tember 30, 1937. The deficiencies asserted are \$991.84 for the fiscal year ended September [6] 30, 1936 and \$15,603.44 for the fiscal year ended September 30, 1937, making a total of \$16,595.28 of which amount approximately \$900.00 for the fiscal year ended September 30, 1936 and \$9,000.00 for the fiscal year ended September 30, 1937 or a total of \$9,900.00 is in controversy.

(4) The determination of tax set forth in the said notice of deficiency was based on the following errors:

(a) In determining the taxable net income of the petitioner for the fiscal year ended September 30, 1936 the Commissioner erroneously disallowed a deduction of \$5,044.13 representing a claimed loss on the abandonment of physical equipment consequent to the abandonment of an oil well located on property leased by the petitioner.

(b) The Commissioner similarly erroneously disallowed losses claimed on the abandonment of similar physical equipment during the year ended September 30, 1937 in amount of \$35,026.52.

(5) The facts upon which the petitioner relies as the basis of its proceeding are as follows:

(a) It was the petitioner's consistent practice from the time it was organized in 1928 to charge intangible development costs in connection with the drilling of oil wells to expense. The tangible development costs for physical equipment used in connection with the drilling of oil wells such as casing, pipe, oil rig, pumping equipment, etc., were capi-

talized in its accounts. The tangible equipment costs for each separate well was separately set up in its records.

During the fiscal year ended September 30, 1936, petitioner abandoned its Red Ribbon Ranch Lease Well No. 6. The loss [7] attributable to the abandonment of this well was computed in its accounts and claimed in its tax returns as follows:

Total cost of tangible equipment capitalized (Well completed during fiscal year ended Sept. 30, 1930)				\$9,093.60
Less depreciation previously written off.....				4,049.47
<hr/>				
Year Ended	Bbls. Produced	Unit Rate	Amount	
Sept. 30-30	12,421	.032668392	405.77	
" " -31	22,876	"	747.32	
" " -32	41,285	.032971291	1,361.22	
" " -33	37,847	.032920749	1,245.95	
" " -34	8,785	"	289.21	
" " -35				
" " -36				
<hr/>				
Total			4,049.47	<hr/>
<hr/>				
Loss				5,044.13
<hr/>				

During the fiscal year ended September 30, 1937, petitioner abandoned its McKeehan Lease Wells No. 1 and No. 3 and its Earl Fruit Company Lease Well No. 1. The losses attributable to the abandonment of the said wells were computed in its accounts and claimed in its tax returns as follows:

McKeehan Well No. 1

Total cost of tangible equipment capitalized (Well completed during fiscal year ended September 30, 1934)	22,304.17
Less depreciation previously written off.....	14,909.37

Year Ended	Bbls. Produced	Unit Rate	Amount
Sept. 30-34	105,426	.043556776	4,592.02
" " -35	114,161	.063458951	7,244.54
" " -36	40,122	"	2,546.10
" " -37	8,300	"	526.71
Total			14,909.37
Loss			7,394.80

[8]

Earl Fruit Well No. 1

Total cost of tangible equipment capitalized (Well completed during fiscal year ended September 30, 1936)	\$15,735.91
Less salvage value of tangible equipment removed from well	2,204.92
Loss	13,530.99

McKeehan Well No. 3

Total cost of tangible equipment capitalized (Well completed during fiscal year ended September 30, 1935)	16,542.36
Less salvage value of tangible equipment removed from well	1,479.75
Balance of equipment abandoned.....	15,062.61
Less depreciation previously written off.....	961.88

Year Ended	Bbls. Produced	Unit Rate	Amount
Sept. 30-35	9,218	.063458951	584.96
" " -36	5,938	"	376.92
" " -37			
			961.88
Loss			14,100.73

The petitioner consistently computed its depreciation on tangible well equipment on the so-called unit of production method. That is to say, the annual depreciation on each separate lease was determined by dividing the potential production in barrels of that lease into the total equipment cost of that lease. The rate per barrel thus arrived at was then multiplied by the number of barrels produced each year to determine the depreciation applicable to each lease. In all cases where there was more than one well on a given lease no separate depreciation account for each well was maintained in the taxpayer's accounts but the production of each well was [9] separately kept so that it was possible to determine at any time the depreciation previously written off for any particular well by multiplying the production of the well by the unit depreciation rate.

The Commissioner has erroneously held that the claimed losses were not deductible in the years during which the said wells were abandoned, but that the undepreciated cost of the said tangible well equipment should be recovered over the life of the remaining wells located on the said leases on the so-called "unit of production" method.

Wherefore, the petitioner prays that this Board may hear the proceeding and determine that the deficiency due from the petitioner for the fiscal year ended September 30, 1936 should not be in excess of approximately \$100.00 and the deficiency for

the year ended September 30, 1937 should not be in excess of approximately \$6,600.00.

Counsel:

LESTER HERRICK and HERRICK
465 California Street
San Francisco, California [10]

JURAT

State of California,
City and County of San Francisco—ss.

Alfred L. Marsten, Jr., being first duly sworn, deposes and says that he is President of Mohawk Petroleum Company, the petitioner above named; that he has authority to verify the foregoing petition; that he has read the same or has had it read to him and is familiar with the statements contained therein, and that the statements contained therein are true, except those stated to be on information and belief, and those he believes to be true.

(Signed) ALFRED L. MARSTEN, JR.

Subscribed and sworn to before me this 19th day of December, 1940.

(Signed) KATHRYN E. STONE
Notary Public in and for the City and County of San Francisco, State of California.
My commission expires March 1, 1941 [11]

EXHIBIT "A"

Form 1231

SN-IT-2

TREASURY DEPARTMENT

Internal Revenue Service
433 Federal Office Building
San Francisco, California

Oct. 4, 1940

Office of
Internal Revenue
Agent in Charge
San Francisco Division
IRA:90-D

DCE
(C:TS:PD
SF:CCG)

Mohawk Petroleum Company,
405 Montgomery Street,
San Francisco, California.

Gentlemen:

You are advised that the determination of your income tax liability for the taxable year(s) 1936, 1937 and 1938, discloses a deficiency of \$16,595.28 for the taxable year(s) 1936 and 1937 and an over-

Exhibit "A"—(Continued)
assessment of \$5,660.87 for the taxable year(s) 1938
as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency mentioned.

Within 90 days (not counting Sunday or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with the United States Board of Tax Appeals for a redetermination of the deficiency.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, San Francisco, California for the attention of —Conference Section— The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully,

GUY T. HELVERING,

Commissioner,

By (Signed) F. M. HARLESS,

Internal Revenue Agent in
Charge

Enclosures:

Statement.

Form of waiver and acceptance. [12]

Exhibit "A"—(Continued)

STATEMENT

San Francisco
 IRA:90-D
 DCE
 (C:TS:PD
 SF:CCG)

Mohawk Petroleum Company,
 405 Montgomery Street,
 San Francisco, California.

TAX LIABILITY FOR THE TAXABLE YEARS ENDED SEPTEMBER 30, 1936,
 SEPTEMBER 30, 1937 AND SEPTEMBER 30, 1938

Income Tax	Liability	Assessed	Overassessment	Deficiency
Fiscal Years ended:				
September 30, 1936.....	\$ 73,428.21	\$ 72,436.37		\$ 991.84
September 30, 1937.....	59,695.95	44,092.51		15,603.44
September 30, 1938.....	68,241.43	73,902.30	\$5,660.87	
	<u>\$201,365.59</u>	<u>\$190,431.18</u>	<u>\$5,660.87</u>	<u>\$16,595.28</u>

Exhibit "A"—(Continued)

In making this determination of your income tax liability, careful consideration has been given to your protest dated May 22, 1940; to the statements made at the conferences held on June 18, 1940 and August 22, 1940 and to your claim for refund filed on September 23, 1939.

It is noted that your claim for refund, covering the fiscal year ended September 30, 1936, is based upon the decision of the United States Circuit Court of Appeals in the case of Wilshire Oil Co. Inc. v. Commissioner, 95 Fed. (2d) 971. Inasmuch as the decision of the Circuit Court of Appeals was reversed by the United States Supreme Court, 308 U. S. 90, 60 S. Ct. 18, the claim for refund will be disallowed and official notice will be issued by registered mail in accordance with section 3772 (a) (2) of the Internal Revenue Code.

The overassessment shown herein will be made the subject of a certificate of overassessment which will reach you in due course through the office of the collector of internal revenue for your district, and will be applied by that official in accordance with section 322 of the Revenue Act of 1936, provided that you fully protect yourself against the running of the statute of limitations with respect to the apparent overassessment referred to in this letter, by filing with the collector of internal revenue for your district, a claim for refund on form 843, a copy of which is enclosed, the basis of which may be as set forth herein. [13]

Exhibit "A"—(Continued)

A copy of this letter and statement has been mailed to your representatives, Lester Herrick and Herrick, 465 California Street, San Francisco, California, in accordance with the authority contained in the power of attorney executed by you and on file in this office.

ADJUSTMENTS TO NET INCOME

Fiscal Year Ended September 30, 1936

Net income as disclosed by return.....	\$512,264.48
Unallowable deductions and	
additional income	
(a) Depreciation	\$23,866.65
(b) Losses	5,044.13
(c) Capital stock tax.....	8,979.00
	37,889.78
Total	550,154.26
Nontaxable income and additional	
deductions	
(d) Depletion	13,913.90
(e) Bad Debts recovered.....	2,216.99
	16,130.89
Net income adjusted.....	534,023.37
	[14]

EXPLANATION OF ADJUSTMENTS

(a) In your return depreciation of equipment on the basis of production in relation to the oil reserve was claimed in the amount of \$257,358.94. The deduction claimed is adjusted as follows:

Exhibit "A"—(Continued)

	Allowed	Deducted	Decrease
Well equipment	\$132,115.49	153,676.88	21,561.39
General field equipment:			
Miscellaneous	72,702.16	77,679.07	4,976.91
Weedpatch absorption plant	22,890.74	24,661.96	1,771.22
Weedpatch gas line..	5,783.90	1,341.03	(4,442.87)
	<hr/>	<hr/>	<hr/>
	233,492.29	257,358.94	23,866.65
	<hr/>	<hr/>	<hr/>

(b) On your return you claimed the deduction of \$5,044.13 in the fiscal year ended September 30, 1936 (and \$35,026.52 in the fiscal year ended September 30, 1937) as a loss sustained through the abandonment of oil well equipment at oil wells shut down during the taxable year although other wells on the same leaseholds continued to operate.

You elected and have continued to deduct depreciation on your oil well equipment on your income tax returns on a unit of production basis based upon the total estimated production of oil to be obtained from an entire leasehold.

Since your tangible oil well equipment installations on each leasehold in question consist of more than one installation and depreciation has been based upon the average lives of all such installations, losses claimed on the normal retirements of such assets are not allowable inasmuch as an average rate contemplates a normal retirement of assets both before and after the average life has been reached and there is therefore, no possibility of ascertaining any actual loss under such circumstances.

Exhibit "A"—(Continued)

until all assets contained in the group have been retired or disposed of.

Therefore the losses claimed in the respective years are disallowed as deductions. See Article 23 (e)-3, Regulations 94 and 101. [15]

(c) The deduction on your return for capital stock tax in the amount of \$18,513.00 is adjusted as follows:

Original declared value of capital stock as disclosed by your capital stock tax return for the fiscal year ended June 30, 1936.....	\$9,000,000.00
Add: Net income for fiscal year ended September 30, 1936.....	534,023.37
Adjusted declared value.....	<u>9,534,023.37</u>
Capital stock tax at \$1.00 per \$1,000.00 of value	9,534.00
Deduction in return.....	<u>18,513.00</u>
Excessive deduction disallowed.....	<u>8,979.00</u>

(d) The deduction in your return for depletion is increased as follows: [16]

Exhibit "A"—(Continued)

	50 Percent of Net Income	27½ Percent of Gross Income	Cost Depletion	Allowable Depletion
Fruitvale Field				
Red Ribbon	\$ 13,774.38	16,256.70	152.34	13,774.38
Doherty	1,447.78	1,726.56		1,447.78
Fishback	8,136.37	9,507.93		8,136.37
Ward	5,355.08	5,643.24		5,355.08
Osborne	None	1,185.32		None
Bowman	None	1,209.32		None
Kern County Land	None	1,015.36	154.06	154.06
Weedpatch Field				
Hood	86,218.86	129,994.31		86,218.86
Clendenen	131,996.99	144,278.82		131,996.99
McKeehan	16,029.40	14,841.64		14,841.64
Bloemer	29,551.62	33,001.31		29,551.62
Mabry	2,703.50	2,341.17		2,341.17
De Reynier	15,392.67	14,705.86	375.56	14,705.86
Earl Fruit Company	None	925.03		None
Manners Royalty	311.62	171.39		171.39
Total depletion allowable				308,695.20
Depletion deducted				294,781.30
Additional deduction allowed				<u>13,913.90</u>

Exhibit "A"—(Continued)

(e) The account of C. F. Frederickson & Son amounting to \$2,216.99 was charged off your books and claimed as a bad debt deduction in your return for the fiscal year ended September 30, 1935. The deduction thereof has been previously disallowed. The account was collected in December 1935 and credited to Miscellaneous Income. The deduction in your 1935 return having been previously disallowed, this amount is eliminated from income. [17]

COMPUTATION OF TAX

Fiscal Year Ended September 30, 1936

Income Tax

Taxable net income.....	\$534,023.37
Income tax at 13 $\frac{3}{4}$ percent.....	73,428.21
Income tax assessed:	
Original list, Account No. 400017—	
First California District.....	70,436.37
Additional May 24, 1940 list—	
Account No. 529002—	
First California District.....	2,000.00
Total assessed	72,436.37
Deficiency of income tax.....	991.84

Exhibit "A"—(Continued)

ADJUSTMENTS TO NET INCOME

Fiscal Year Ended September 30, 1937

Net income as disclosed by line 27, page 2 of your return.....	109,045.17
Unallowable deductions and additional income	
(a) Depletion	58,242.11
(b) Depreciation	19,717.13
(c) Equipment losses	35,026.52
(d) Loss—Weedpatch absorption plant	1,041.72
(e) Capital gain	11,693.23
(f) Capital stock tax.....	3,622.00
	129,342.71
Net income adjusted.....	238,387.88
	<u><u>[18]</u></u>

EXPLANATION OF ADJUSTMENTS

(a) The deduction in your return for depletion is adjusted as follows:

Exhibit "A"—(Continued)

	50 percent of Net Income	27½ percent of Gross Income	Cost Depletion	Depletion Allowable
Fruitvale Field:				
Red Ribbon	\$6,046.18	14,711.72		6,046.18
Doherty	857.20	1,327.99		857.20
Fishback	2,973.73	6,128.34		2,973.73
Ward	2,128.95	3,316.95		2,128.95
Osborn	2,519.27	7,786.77		2,519.27
Bowman	462.83	2,246.64		462.83
Kern County Land	None	8,624.15	1,308.41	1,308.41
Weedpatch Field:				
Hood	3,778.67	43,342.71		3,778.67
Clendenen	15,831.67	64,703.42		15,831.67
McKeehan	5,963.11	7,480.64		5,963.11
Bloemer	20,756.86	23,122.24		20,756.86
Mabry	None	580.04		None
De Reynier	7,299.90	11,384.33		7,299.90
Earl Fruit Co.....	None	9,504.76		None
Manners Royalty	255.88	140.73		140.73
Total depletion allowable				70,067.51
Deduction claimed in your return				128,309.62
Excessive deduction disallowed				58,242.11

Exhibit "A"—(Continued)

(b) In your return depreciation of equipment on the basis of production in relation to the oil reserve was claimed in the amount of \$257,358.94. The deduction claimed is adjusted as follows: [19]

	Allowed	Deducted	Decrease
Well equipment	\$ 84,140.35	103,722.52	19,582.17
General field equipment:			
Miscellaneous	52,436.13	56,605.08	4,168.95
Weedpatch absorption plant	9,776.32	6,983.22	(2,793.10)
Weedpatch gas line..	2,470.17	1,229.28	(1,240.89)
	<hr/>	<hr/>	<hr/>
Total	<u>148,822.97</u>	<u>168,540.10</u>	<u>19,717.13</u>

(c) See adjustment (b) for 1936.

(d) The loss claimed in your return on account of abandonment of the Weedpatch absorption plant is adjusted as follows:

Total cost of plant.....	85,339.86
Less: Depreciation sustained.....	52,101.74
	<hr/>
Net cost at abandonment.....	33,238.12
Less salvage	1,500.00
	<hr/>
Net loss	31,738.12
Loss deducted	32,779.84
	<hr/>
Excessive deduction disallowed.....	<u>1,041.72</u>

(e) In your return you claimed a loss of \$3,076.96 on the sale of Weedpatch gas lines to Lomita Gasoline Company whereas it has been determined that you realized a profit of \$8,616.27. Adjustment therefor is accordingly made as follows:

Exhibit "A"—(Continued)

Amount received from sale.....	16,000.00
Cost	22,831.48
Less: Depreciation sustained.....	15,447.75
Net cost at date of sale.....	7,383.73
Profit realized	8,616.27
Loss reported	3,076.96
Total adjustment	11,693.23
	[20]

(f) The deduction on your return for accrued capital stock tax is adjusted to the amount actually paid for the fiscal year ended June 30, 1938 as follows:

Deduction for accrued capital stock tax.....	\$ 9,622.00
Actual payment in 1938.....	6,000.00
Difference restored to income.....	3,622.00

COMPUTATION OF TAX
Fiscal Year Ended September 30, 1937

Income Tax:

Normal Tax:

Taxable net income.....	238,387.88
Less: Dividends received credit, for companies other than mutual investment companies (85 percent of dividends received from taxable domestic corporations).....	2,885.75
Normal tax net income.....	235,502.13
8 percent of \$ 2,000.00 (over 0 to \$ 2,000).....	160.00
11 percent of \$ 13,000.00 (over \$ 2,000 to \$15,000).....	1,430.00
13 percent of \$ 25,000.00 (over \$15,000 to \$40,000).....	3,250.00
15 percent of \$195,502.13 (over \$40,000).....	29,325.32
Total normal tax.....	34,165.32
	[21]

Exhibit "A"—(Continued)

Surtax on Undistributed Profits:

Taxable net income.....	\$238,387.88
Less: Normal Tax.....	34,165.32
Adjusted net income.....	204,222.56
Less: Dividends paid credit.....	60,500.00
Undistributed net income.....	143,722.56
7 percent of \$20,422.26.....	1,429.56
12 percent of \$20,422.26.....	2,450.67
17 percent of \$40,844.51.....	6,943.57
22 percent of \$40,844.51.....	8,985.79
27 percent of \$21,189.02.....	5,721.04
Total surtax	25,530.63
Normal tax	34,165.32
Total income tax (normal tax and surtax).....	59,695.95
Income tax assessed (normal tax and surtax):	
Original list, account No. 400011—	
First California District.....	19,092.51
Additional list, account No. 529003—	
May 1940—First California	
District	25,000.00
	44,092.51
Deficiency of income tax.....	15,603.44

ADJUSTMENTS TO NET INCOME Fiscal Year Ended September 30, 1938

Net income as disclosed by line 28,
page 2 of your return..... \$507,623.32

**Unallowable deductions and
additional income**

(a) Depletion	23,301.97
(b) Depreciation	8,048.09
(c) Abandonment losses	37,864.73
(d) Administrative expense	27,500.00
Total	604,338.11

Exhibit "A"—(Continued)

Nontaxable income and additional deductions	
(e) Capital gain	134,453.89
Net income adjusted.....	<u>469,884.22</u>
	[23]

EXPLANATION OF ADJUSTMENTS

(a) The deduction in your return for depletion
is adjusted as follows:

Exhibit "A"—(Continued)

	50 percent of net Income	27½ percent of Gross Income	Cost Depletion	Depletion Allowable
Fruitvale Field				
Red Ribbon	\$ None	5,688.89		None
Doherty	None	399.31		None
Fishback	None	1,452.43		None
Ward	42.23	973.03		42.23
Osborne	None	2,189.83		None
Bowman	None	336.58		None
Kern County Land	None	817.25	124.01	124.01
Weedpatch Field				
Hood	14,390.14	15,069.25		14,390.14
Clendinen	17,929.75	17,948.53		17,929.75
McKeehan	1,900.69	1,920.10		1,900.69
Bloemer	4,674.97	4,972.26		4,674.97
De Reynier	2,485.67	3,045.90		2,485.67
Earl Fruit Company	301.44	8,493.18		301.44
Manners Royalty	87.15	47.93		47.93
Total depletion allowable				41,896.83
Deduction claimed in your return				65,198.80
Excessive deduction disallowed				<u><u>23,301.97</u></u>

Exhibit "A"—(Continued)

(b) In your return depreciation of equipment on the basis of production in relation to the oil reserve was deducted in the amount of \$51,872.67. The deduction claimed is adjusted as follows:

	Allowed	Deducted	Decrease
Well equipment	28,227.24	32,381.89	4,154.65
General field equipment	15,597.34	19,490.78	3,893.44
 Total	<u>43,824.58</u>	<u>51,872.67</u>	<u>8,048.09</u>
			[24]

(c) Equipment losses claimed in your return on account of the abandonment of certain wells are disallowed as a deduction for reasons explained in adjustment (b) for 1936.

(d) Payments of \$13,750.00 each made to your president, A. L. Marsten, Jr., and your vice-president, Lewis A. Marsten, in the guise of bonuses are held to be a distribution of income. The deduction thereof in your return is accordingly disallowed.

(e) In your return you reported a taxable profit of \$313,011.50 from the sale of your plant and equipment. The profit reported is reduced by the sum of \$134,453.89 representing adjustments made to plant and equipment accounts for the fiscal years 1936, 1937 and 1938 as follows:

1936

Excessive depreciation disallowed.....	\$23,866.65	
Less: Amount restored on your books		
by credit to surplus.....	7,848.31	16,018.34
 Red Ribbon Well #6—Abandonment loss		
disallowed		5,044.13

Exhibit "A"—(Continued)

1937

Excessive depreciation disallowed.....	19,717.13
Abandonment losses disallowed:	
McKeehan Well #3.....	14,100.73
McKeehan Well #1.....	7,394.80
Earl Fruit Well #1.....	13,530.99
Absorption plant (excessive loss claimed).....	1,041.72
Excessive cost deducted — Weepatch gas lines sale	11,693.23
1938	
Excessive depreciation disallowed.....	8,048.09
Abandonment losses disallowed:	
Kern County Land Co. Well #4.....	4,127.38
Hood Well #4.....	7,429.80
Hood Well #3.....	8,005.97
Hood Well #9.....	18,301.58
Total adjustment	134,453.89
	[25]

COMPUTATION OF TAX
Fiscal Year Ended September 30, 1938

Income Tax:

Normal Tax:

Taxable net income.....	\$469,884.22
Less: Dividends received credit, for companies other than mutual investment companies	
(85 percent of dividends received from tax- able domestic corporations).....	7,208.00
Normal Tax net income.....	462,676.22
8 percent of \$ 2,000.00 (over \$ 0 to \$ 2,000)	160.00
11 percent of \$ 13,000.00 (over \$ 2,000 to \$15,000)	1,430.00
13 percent of \$ 25,000.00 (over \$15,000 to \$40,000)	3,250.00
15 percent of \$422,676.22 (over \$40,000).....	63,401.43

Total normal tax.....	68,241.43
Surtax on Undistributed Profits:	
Taxable net income.....	469,884.22

Exhibit "A"—(Continued)

Less: Normal tax.....	68,241.43
Adjusted net income.....	401,642.79
Less: Dividends paid credit.....	816,877.94
Undistributed net income.....	None
Total income tax.....	68,241.43
Income tax assessed	
Original list, account No. 400004—	
First California District.....	73,902.30
Overassessment of income tax.....	5,660.87

[Endorsed]: U.S.B.T.A. Filed Dec. 24, 1940.

[26]

[Title of Board and Cause.]

Docket No. 105967

ANSWER

Comes now the Commissioner of Internal Revenue, respondent above named, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and for answer to the petition filed by the above named petitioner, admits and denies as follows:

- (1). Admits the allegations contained in paragraph (1) of the petition.
- (2). Admits the allegations contained in paragraph (2) of the petition.
- (3). Admits that the taxes in controversy are income taxes for the fiscal years ended September 30,

1936 and September 30, 1937; that the deficiencies asserted are \$991.84 for the fiscal year ended September 30, 1936 and \$15,603.44 for the fiscal year ended September 30, 1937, making a total of \$16,595.28; denies the remaining allegations contained in paragraph (3) of the petition. [27]

(4) (a) and (b). Denies that the Commissioner erred in the determination of the deficiency as alleged in subparagraphs (a) and (b) of paragraph (4) of the petition.

(5) (a). Admits the first paragraph contained in subparagraph (a) of paragraph (5) of the petition, and that the petitioner consistently computed its depreciation on tangible well equipment on the so-called unit of production method, that in all cases where there was more than one well on a given lease no separate depreciation account for each well was maintained in the taxpayer's accounts, but denies the remaining allegations contained in said paragraph.

6. Denies generally and specifically each and every allegation in the petition not hereinbefore admitted, qualified, or denied.

Wherefore, it is prayed that the Commissioner's determination be approved and the petitioner's appeal denied.

(Signed) J. P. WENCHEL
T.M.M.

Chief Counsel, Bureau of Internal Revenue.

Of Counsel:

ALVA C. BAIRD,
Division Counsel;
T. M. MATHER,
Special Attorney,
Bureau of Internal Revenue.

[Endorsed]: U.S.B.T.A. Filed Jan. 28, 1941.

[28]

United States Board of Tax Appeals

Docket No. 105968

ALFRED L. MARSTEN, JR.,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION

(1) The petitioner is an individual and resides in the City and County of San Francisco, State of California. His business address is 405 Montgomery Street, San Francisco, California. The returns for the periods here involved were filed with the Collector of United States Internal Revenue for the First District of California. [29]

(5) The facts upon which the petitioner relies as the basis for his proceeding are as follows:

(a) The petitioner was the owner of 3,600 shares

of stock of Mohawk Petroleum Company. The said company distributed all of its assets to its stockholders prior to October 4, 1940. The petitioner received a portion of the assets of the said Mohawk Petroleum Company as a liquidating dividend. The respondent asserts and petitioner admits that he is a transferee of the assets of the said Mohawk Petroleum Company.

[Endorsed]: U. S. B. T. A. Filed Dec. 24, 1940. [30]

[Title of Board and Cause.]

Docket No. 105968

ANSWER

Comes now the Commissioner of Internal Revenue, respondent above-named, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and for answer to petition filed by the above-named petitioner, admits, denies, and alleges as follows:

(1). Admits the allegations contained in paragraph (1) of the petition.

(2). Admits the allegations contained in paragraph (2) of the petition.

(3). Admits that the taxes in controversy are income taxes for the fiscal years ended September 30, 1936 and September 30, 1937, that the deficiencies asserted are \$991.84 for the fiscal year ended September 30, 1936 and \$15,603.44 for the fiscal year ended September 30, 1937, but denies

the remaining allegations contained in paragraph (3) of the petition. [49]

(4) (a) and (b). Denies that the Commissioner erred in the determination of the deficiencies as alleged in subparagraphs (a) and (b) of paragraph (4) of the petition.

(5) (a). Admits the allegations contained in subparagraph (a) of paragraph (5) of the petition.

(5) (b). Admits the first paragraph contained in subparagraph (b) of paragraph (5) of the petition, and that the company consistently computed its depreciation on tangible well equipment on the so-called unit of production method; that in all cases where there was more than one well on a given lease no separate depreciation account for each well was maintained in the taxpayer's accounts; for lack of information, denies the remaining allegations contained in said paragraph.

(6). Denies generally and specifically each and every allegation in the petition not hereinbefore admitted, qualified, or denied.

(7). Further answering, respondent alleges as follows:

1. Mohawk Petroleum Company has heretofore dissolved and distributed its assets to its stockholders, including this petitioner, who assumed all its liabilities, including any liability for Federal income tax.

2. The assets so transferred to petitioner had a value in excess of the Federal tax liability of Mohawk Petroleum [50] Company, for the taxable years ended September 30, 1936, and September 30,

1937, involved in this proceeding, together with interest thereon as provided by law.

3. Mohawk Petroleum Company is now, and ever since its dissolution has been, insolvent and without assets out of which its income tax liability, together with interest thereon as provided by law, can be satisfied, and no part of said liability has ever been paid.

4. The petitioner as transferee, and by reason of the facts herein alleged, is liable for the payment of the amount of the deficiencies here involved, together with interest as provided by law.

Wherefore, it is prayed that the petitioner's appeal be denied, and that the Commissioner's determination be approved, and that petitioner be held liable at law and in equity as transferee of the Mohawk Petroleum Company for a deficiency for the taxable year ended September 30, 1936, in the amount of \$991.84, and for the taxable year ended September 30, 1937, in the amount of \$15,603.44, together with interest thereon as provided by law.

J. P. WENCHEL,

T.M.M.

Chief Counsel, Bureau of Internal Revenue.

Of Counsel:

ALVA C. BAIRD,
Division Counsel;

T. M. MATHER,
Special Attorney,
Bureau of Internal Revenue.

[Endorsed]: U. S. B. T. A. Filed Jan. 24,
1941. [51]

United States Board of Tax Appeals

Docket No. 105969

LEWIS A. MARSTEN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION

(1) The petitioner is an individual and resides in the City and County of San Francisco, State of California. His business address is 405 Montgomery Street, San Francisco, California. The returns for the periods here involved were filed with the Collector of United States Internal Revenue for the First District of California. [52]

(5) The facts upon which the petitioner relies as the basis for his proceeding are as follows:

(a) The petitioner was the owner of 3,600 shares of stock of Mohawk Petroleum Company. The said company distributed all of its assets to its stockholders prior to October 4, 1940. The petitioner received a portion of the assets of the said Mohawk Petroleum Company as a liquidating dividend. The respondent asserts and petitioner admits that he is a transferee of the assets of the said Mohawk Petroleum Company.

[Endorsed]: U. S. B. T. A. Filed Dec. 24,
1940. [53]

[Title of Board and Cause.]

Docket No. 105969

ANSWER

Comes now the Commissioner of Internal Revenue, respondent above named, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and for answer to the petition filed by the above-named petitioner, admits, denies, and alleges as follows:

(1) Admits the allegations contained in paragraph (1) of the petition.

(2) Admits the allegations contained in paragraph (2) of the petition.

(3) Admits that the taxes in controversy are income taxes for the fiscal years ended September 30, 1936 and September 30, 1937, that the deficiencies asserted are \$991.84 for the fiscal year ended September 30, 1936 and \$15,603.44 for the fiscal year ended September 30, 1937, but denies the remaining allegations contained in paragraph (3) of the petition. [73]

(4) (a) and (b) Denies that the Commissioner erred in the determination of the deficiencies as alleged in subparagraphs (a) and (b) of paragraph (4) of the petition.

(5) (a) Admits the allegations contained in subparagraph (a) of paragraph (5) of the petition.

(5) (b) Admits the first paragraph contained in subparagraph (b) of paragraph (5) of the petition, and that the company consistently computed

its depreciation on tangible well equipment on the so-called unit of production method; that in all cases where there was more than one well on a given lease no separate depreciation account for each well was maintained in the taxpayer's accounts; for lack of information, denies the remaining allegations contained in said paragraph.

(6) Denies generally and specifically each and every allegation in the petition not hereinbefore admitted, qualified, or denied.

(7) Further answering, respondent alleges as follows:

1. Mohawk Petroleum Company has heretofore dissolved and distributed its assets to its stockholders, including this petitioner, who assumed all its liabilities, including any liability for Federal income tax.

2. The assets so transferred to petitioner had a value in excess of the Federal tax liability of Mohawk Petroleum Company, for the taxable years ended September 30, 1936, and [74] September 30, 1937, involved in this proceeding, together with interest thereon as provided by law.

3. Mohawk Petroleum Company is now, and ever since its dissolution has been, insolvent and without assets out of which its income tax liability, together with interest thereon as provided by law, can be satisfied, and no part of said liability has ever been paid.

4. The petitioner as transferee, and by reason of the facts herein alleged, is liable for the payment

of the amount of the deficiencies here involved, together with interest as provided by law.

Wherefore, it is prayed that the petitioner's appeal be denied, and that the Commissioner's determination be approved, and that petitioner be held liable at law and in equity as transferee of the Mohawk Petroleum Company for a deficiency for the taxable year ended September 30, 1936, in the amount of \$991.84, and for the taxable year ended September 30, 1937, in the amount of \$15,603.44, together with interest thereon as provided by law.

(Signed) J. P. WENCHEL,
T.M.M.

Chief Counsel, Bureau of Internal Revenue.

Of Counsel:

ALVA C. BAIRD,
Division Counsel;
T. M. MATHER,
Special Attorney,
Bureau of Internal Revenue.

[Endorsed]: U. S. B. T. A. Filed Jan. 28,
1941. [75]

United States Board of Tax Appeals

Docket No. 105970

EDWIN V. MCKENZIE,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION

(1) The petitioner is an individual and resides in the City and County of San Francisco, State of California. His business address is 1049 Mills Building, San Francisco, California. The returns for the periods here involved were filed with the Collector of United States Internal Revenue for the First District of California. [76]

(5) The facts upon which the petitioner relies as the basis for his proceeding are as follows:

(a) The petitioner was the owner of 1,000 shares of stock of Mohawk Petroleum Company. The said company distributed all of its assets to its stockholders prior to October 4, 1940. The petitioner received a portion of the assets of the said Mohawk Petroleum Company as a liquidating dividend. The respondent asserts and petitioner admits that he is a transferee of the assets of the said Mohawk Petroleum Company.

[Endorsed]: U. S. B. T. A. Filed Dec. 24,
1940. [77]

[Title of Board and Cause.]

Docket No. 105970

ANSWER

Comes now the Commissioner of Internal Revenue, respondent above named, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and for answer to the petition filed by the above-named petitioner, admits, denies, and alleges as follows:

(1). Admits the allegations contained in paragraph (1) of the petition.

(2). Admits the allegations contained in paragraph (2) of the petition.

(3). Admits that the taxes in controversy are income taxes for the fiscal years ended September 30, 1936 and September 30, 1937, that the deficiencies asserted are \$991.84 for the fiscal year ended September 30, 1936 and \$15,603.44 for the fiscal year ended September 30, 1937, but denies the remaining allegations contained in paragraph (3) of the petition. [96]

(4) (a) and (b). Denies that the Commissioner erred in the determination of the deficiencies as alleged in subparagraphs (a) and (b) of paragraph (4) of the petition.

(5) (a). Admits the allegations contained in subparagraph (a) of paragraph (5) of the petition.

(5) (b). Admits the first paragraph contained in subparagraph (b) of paragraph (5) of the petition, and that the company consistently computed its de-

preciation on tangible well equipment on the so-called unit of production method; that in all cases where there was more than one well on a given lease no separate depreciation account for each well was maintained in the taxpayer's accounts; for lack of information, denies the remaining allegations contained in said paragraph.

(6). Denies generally and specifically each and every allegation in the petition not hereinbefore admitted, qualified, or denied.

(7). Further answering, respondent alleges as follows:

1. Mohawk Petroleum Company has heretofore dissolved and distributed its assets to its stockholders, including this petitioner, who assumed all its liabilities, including any liability for Federal income tax.

2. The assets so transferred to petitioner had a value in excess of the Federal tax liability of Mohawk Petroleum Company, for the taxable years ended September 30, 1936, and [97] September 30, 1937, involved in this proceeding, together with interest thereon as provided by law.

3. Mohawk Petroleum Company is now, and ever since its dissolution has been, insolvent and without assets out of which its income tax liability, together with interest thereon as provided by law, can be satisfied, and no part of said liability has ever been paid.

4. The petitioner as transferee, and by reason of the facts herein alleged, is liable for the pay-

ment of the amount of the deficiencies here involved, together with interest as provided by law.

Wherefore, it is prayed that the petitioner's appeal be denied, and that the Commissioner's determination be approved, and that petitioner be held liable at law and in equity as transferee of the Mohawk Petroleum Company for a deficiency for the taxable year ended September 30, 1936, in the amount of \$991.84, and for the taxable year ended September 30, 1937, in the amount of \$15,603.44, together with interest thereon as provided by law.

(Signed) J. P. WENCHEL,
T.M.M.

Chief Counsel, Bureau of
Internal Revenue.

Of Counsel:

ALVA C. BAIRD,
Division Counsel;
T. M. MATHER,
Special Attorney,
Bureau of Internal Revenue.

[Endorsed]: U. S. B. T. A. Filed Jan. 28, 1941.
[98]

United States Board of Tax Appeals

Docket No. 105971

ESTATE OF ALFRED L. MARSTEN, Deceased,
EDWIN V. MCKENZIE, Executor

Petitioner

vs.

COMMISSIONER OF INTERNAL REVENUE
Respondent

PETITION

(1) The petitioner is Edwin V. McKenzie as Executor of the Estate of Alfred L. Marsten, Deceased, and his address is 1049 Mills Building, San Francisco, California. The returns for the periods here involved were filed with the Collector of United States Internal Revenue for the First District of California. [99]

(5) The facts upon which the petitioner relies as the basis for his proceeding are as follows:

(a) The petitioner was the owner of 52,300 shares of stock of Mohawk Petroleum Company. The said company distributed all of its assets to its stockholders prior to October 4, 1940. The petitioner received a portion of the assets of the said Mohawk Petroleum Company as a liquidating dividend. The respondent asserts and petitioner admits that he is a transferee of the assets of the said Mohawk Petroleum Company.

[Endorsed]: U. S. B. T. A. Filed Dec. 24, 1940.

[100]

[Title of Board and Cause.]

Docket No. 105971

ANSWER

Comes now the Commissioner of Internal Revenue, respondent above named, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and for answer to the petition filed by the above-named petitioner, admits, denies, and alleges as follows:

(1). Admits the allegations contained in paragraph (1) of the petition.

(2). Admits the allegations contained in paragraph (2) of the petition.

(3). Admits that the taxes in controversy are income taxes for the fiscal years ended September 30, 1936 and September 30, 1937, that the deficiencies asserted are \$991.84 for the fiscal year ended September 30, 1936 and \$15,603.44 for the fiscal year ended September 30, 1937, but denies the remaining allegations contained in paragraph (3) of the petition. [120]

(4) (a) and (b). Denies that the Commissioner erred in the determination of the deficiencies as alleged in subparagraphs (a) and (b) of paragraph (4) of the petition.

(5) (a). Admits the allegations contained in sub-subparagraph (b) of paragraph (5) of the petition,

(5) (b). Admits the first paragraph contained in paragraph (a) of paragraph (5) of the petition, and that the company consistently computed its de-

preciation on tangible well equipment on the so-called unit of production method; that in all cases where there was more than one well on a given lease no separate depreciation account for each well was maintained in the taxpayer's accounts; for lack of information, denies the remaining allegations contained in said paragraph.

(6). Denies generally and specifically each and every allegation in the petition not hereinbefore admitted, qualified, or denied.

(7). Further answering, respondent alleges as follows:

1. Mohawk Petroleum Company has heretofore dissolved and distributed its assets to its stockholders, including this petitioner, who assumed all its liabilities, including any liability for Federal income tax.

2. The assets so transferred to petitioner had a value in excess of the Federal tax liability of Mohawk Petroleum Company, for the taxable years ended September 30, 1936, and [121] September 30, 1937, involved in this proceeding, together with interest thereon as provided by law.

3. Mohawk Petroleum Company is now, and ever since its dissolution has been insolvent and without assets out of which its income tax liability, together with interest thereon as provided by law, can be satisfied, and no part of said liability has ever been paid.

4. The petitioner as transferee, and by reason of the facts herein alleged, is liable for the payment

of the amount of the deficiencies here involved, together with interest as provided by law.

Wherefore, it is prayed that the petitioner's appeal be denied, and that the Commissioner's determination be approved, and the petitioner be held liable at law and in equity as transferee of the Mohawk Petroleum Company for a deficiency for the taxable year ended September 30, 1936, in the amount of \$991.84, and for the taxable year ended September 30, 1937, in the amount of \$15,603.44, together with interest thereon as provided by law.

(Signed) J. P. WENCHEL

T.M.M.

Chief Counsel,

Bureau of Internal Revenue.

Of Counsel:

ALVA C. BAIRD,
Division Counsel;

T. M. MATHER,
Special Attorney,
Bureau of Internal Revenue.

[Endorsed]: Filed Jan. 28, 1941. [122]

United States Board of Tax Appeals

Docket No. 105967

MOHAWK PETROLEUM COMPANY

Petitioner

vs.

COMMISSIONER OF INTERNAL REVENUE

Respondent

STIPULATION OF FACTS

It is hereby mutually stipulated and agreed by and between the parties hereto that the facts in respect to this matter are as follows:

The petitioner, Mohawk Petroleum Company, acquired certain oil and gas leases upon lands in the Fruitvale Oil Field in Kern County, California, shortly after its organization in 1928. One of the leases so acquired was called the Red Ribbon Ranch Lease. At the time of the acquisition of this lease there was a producing oil well located thereon. Five additional wells were drilled on the said Red Ribbon Ranch Lease by petitioner in 1929, 1930 and 1931 and all of the five wells became producing oil wells.

The petitioner has consistently closed its books and filed its income tax returns on the basis of a fiscal year ending September 30. All of the six wells located on the Red Ribbon Ranch Lease continued to produce crude oil until during the fiscal year ended September 30, 1934, when one well became

nonproductive. This well, petitioner's Red Ribbon Ranch Lease Well No. 6, was finally abandoned in the fiscal year ended September 30, 1936. The other five wells located on the said Red Ribbon Ranch Lease continued to produce crude oil for several years after the year ended September 30, 1936. [123]

On December 12, 1932, the petitioner entered into an oil and gas lease with E. B. and Frona McKeehan covering certain lands in the Weedpatch Oil Field in Kern County, California. During the fiscal year ended September 30, 1934, two producing oil wells were drilled on the said McKeehan Lease and during the fiscal year ended September 30, 1935, one producing oil well was drilled on the said lease. During the fiscal year ended September 30, 1937, Wells No. 1 and No. 3 on the said McKeehan Lease became nonproductive and were abandoned. Well No. 2 on the said lease continued to produce for several years after the fiscal year ended September 30, 1937.

On March 17, 1936, the petitioner entered into an oil and gas lease with Earl Fruit Company, a corporation, covering certain lands in Kern County, California. During the fiscal year ended September 30, 1936, one oil well was completed on the said Earl Fruit Company Lease and during the fiscal year ended September 30, 1937, two additional wells were completed on the said lease. Earl Fruit Company Lease Well No. 1 started production of crude oil in August 1936 and became nonproductive in May of 1937 and was abandoned prior to Septem-

ber 30, 1937. Well No. 2 on the said Earl Fruit Company Lease was completed in January 1937 but was not a commercially productive well and was abandoned shortly after completion and the capitalized cost of the said well was written off as a dry hole loss and allowed as such by the respondent in the fiscal year ended September 30, 1937. Earl Fruit Company Lease Well No. 3 was completed in March 1937 and produced crude oil for several years after its completion. Two additional producing wells were later completed on this lease. [124]

Ever since its organization in 1928, petitioner has consistently deducted intangible development costs in connection with drilling oil wells as expense and has capitalized the cost of tangible oil well equipment. The cost so capitalized of each separate well was set up separately in the petitioner's books. The cost so capitalized applicable to the wells here in question is as follows:

Red Ribbon Ranch Lease Well No. 6.....	\$ 9,093.60
McKeehan Lease Well No. 1.....	22,304.17
McKeehan Lease Well No. 3.....	16,542.36
Earl Fruit Company Lease Well No. 1.....	15,735.91

Ever since its organization in 1928, petitioner has consistently computed depreciation on the capitalized cost of its oil wells on the so-called unit of production method. That is to say, the annual depreciation applicable to the capitalized cost of the wells located on a particular lease was determined by dividing the capitalized cost (after a 10% reduction for estimated salvage value) of all the wells

on a particular lease by the estimated net potential crude oil production of the lease and the unit cost per barrel thus determined was then multiplied by the net number of barrels produced during the year from that particular lease to arrive at the amount of depreciation for the year. Exhibit "A" attached hereto and made a part hereof is a statement of the petitioner's Red Ribbon Ranch Lease in analysis of the net capitalized cost of well equipment subject to depreciation, depreciation thereon, estimated total potential production, annual production, etc., by years from the year ended September 30, 1929 to September 30, 1936, inclusive, in illustration of the method used in determining the annual depreciation of oil well equipment. The same basic method was used in determining depreciation of oil well equipment with respect to petitioner's McKeehan Lease, hereinbefore referred to, and to depreciation of [125] oil well equipment with respect to all other producing oil leases owned by petitioner.

The depreciation reserve account in the petitioner's general ledger relating to depreciation on the capitalized cost of its oil wells is segregated between the depreciation applicable to each separate oil lease but is not segregated as between each separate oil well located on a particular lease.

Ever since its organization in 1928, petitioner has maintained a record of the crude oil production of each separate oil well.

During the fiscal year ended September 30, 1936,

petitioner wrote off as a loss consequent to the abandonment of its Red Ribbon Well No. 6 in that year an amount of \$5,044.13, which said amount was computed as follows:

Total cost of tangible equipment capitalized.....	\$9,093.60
Less depreciation previously written off.....	4,049.47

Year ended	Net Bbls. Produced after Royalty to Lessor— Red Ribbon Well No. 6	Unit Deprecn. Rate applicable to Red Ribbon Ranch Lease Well Equipment	Amount
Sept. 30, 1930	12,421	\$.032668392	405.77
Sept. 30, 1931	22,876	.032668392	747.32
Sept. 30, 1932	41,285	.032971291	1,361.22
Sept. 30, 1933	37,847	.032920749	1,245.95
Sept. 30, 1934	8,785	.032920749	289.21
Sept. 30, 1935	None	.	None
Sept. 30, 1936	None		None
 Total			 4,049.47
 Abandonment Loss			 <u>5,044.13</u>

During the fiscal year ended September 30, 1937, petitioner wrote off as losses consequent to the abandonment of its McKeehan Wells No. 1 and No. 3 and its Earl Fruit Company Well No. 1 a total amount of \$35,026.52, which amount was computed as follows: [126]

Loss on McKeehan Well No. 1

Total cost of tangible equipment capitalized.....	\$22,304.17
Less depreciation previously written off.....	14,909.37

Year ended	Net Bbls. Produced after Royalty to Lessor— McKeehan Well No. 1	Unit Deprecn. Rate applicable to McKeehan Lease Well Equipment	Amount
Sept. 30, 1934	105,426	\$.043556776	4,592.02
Sept. 30, 1935	114,161	.063458951	7,244.54
Sept. 30, 1936	40,122	.063458951	2,546.10
Sept. 30, 1937	8,300	.063458951	526.71
 Total			 14,909.37

Loss on McKeehan Well No. 1.....	7,394.80
	 16,542.36

Loss on McKeehan Well No. 3

Total cost of tangible equipment capitalized.....	16,542.36
Less salvage value of tangible equipment removed from well	1,479.75
 Balance of equipment abandoned.....	 15,062.61
Less depreciation previously written off.....	961.88

Year ended	Net Bbls. Produced after Royalty to Lessor— McKeehan Well No. 3	Unit Deprecn. Rate applicable to McKeehan Lease Well Equipment	Amount
Sept. 30, 1935	9,218	\$.063458951	584.96
Sept. 30, 1936	5,938	.063458951	376.92
Sept. 30, 1937	None		—
 Total			 961.88

Loss on McKeehan Well No. 3.....	14,100.73
	 15,735.91

Loss on Earl Fruit Company Well No. 1	
Total cost of tangible equipment capitalized.....	15,735.91
Less salvage value of tangible equipment removed from well	2,204.92
 Balance	 13,530.99
Depreciation previously written off.....	None

Petitioner did not adjust the cost of well equipment on account of depreciation in its computation of loss on the abandonment of Earl Fruit Company Lease Well No. 1 because at the time of closing its books for the fiscal year ended September 30, 1936 it had no reliable engineering reports as to the possible potential crude oil production from this lease and accordingly had insufficient data to compute depreciation with respect to the said lease for the said year and did not compute any depreciation in its books nor claim any depreciation in its income tax return with respect to the said lease for the said year. Respondent computed and allowed depreciation applicable to the well equipment located on said Earl Fruit Company Lease for the year ended September 30, 1936 as follows:

	Total Cost of Tangible Eqpt.	Less Estimated Salvage 10%	Balance subject to Deprec.	*Unit Cost (Per Bbl.)	Net Production after Royalty to Lessor	Deprecn.
Well No. 1.....	\$15,735.91	1,573.59	14,162.32			
		400.33	3,602.96			
Well No. 2.....	4,003.29					
Total	19,739.20	1,973.92	17,765.28	.1188687	2,884.00	342.82

* Based on total net potential production (after deduction of royalty to lessor) of 149,453 barrels of crude oil.

In his final determination of tax for the fiscal year ended September 30, 1936, the respondent disallowed the claimed deduction of \$5,044.13 consequent to the abandonment of petitioner's Red Ribbon Ranch Lease Well No. 6 and similarly disallowed during the fiscal year ended September 30, 1937 claimed deductions totaling \$35,026.52 consequent to the abandonment of petitioner's McKeehan Lease Wells No. 1 and No. 3 and Earl Fruit Company Lease Well No. 1 for the following reason: [128]

"(b) On your return you claimed the deduction of \$5,044.13 in the fiscal year ended September 30, 1936 (and \$35,026.52 in the fiscal year ended September 30, 1937) as a loss sustained through the abandonment of oil well equipment at oil wells shut down during the taxable year although other wells on the same leaseholds continued to operate.

You elected and have continued to deduct depreciation on your oil well equipment on your income tax returns on a unit of production basis based upon the total estimated production of oil to be obtained from an entire leasehold.

Since your tangible oil well equipment installations on each leasehold in question consist of more than one installation and depreciation has been based upon the average lives of all such installations, losses claimed on the normal retirements of such assets are not allowable inasmuch as an average rate contemplates a normal retirement of assets both before and after the average life has been reached and

there is therefore, no possibility of ascertaining any actual loss under such circumstances until all assets contained in the group have been retired or disposed of.

Therefore the losses claimed in the respective years are disallowed as deductions. See Article 23 (e)-3, Regulations 94 and 101."

FRED H. BROWN

For Petitioner

J. P. WENCHEL, JR.

For Respondent. [129]

RED RIBBON RANCH LEASE
EXHIBIT "A"

A	B	C	D	E	F
Capitalized Cost of Oil Well Expt. after 10% reduction for salvage (all wells combined)	Deprecn. (E X F)	Net Balance (A minus B)	Estimated Oil Reserves (Barrels) (c)	Production (c)	Unit Cost (per Barrel) See Note (a)
Year ended 9-30-29	\$105,589.73	3,878.04	101,711.69	3,487.881	\$.030273317
Year ended 9-30-30	8,046.92	7,837.18	209.74	239.901	.032668392
Balance 10- 1-30	113,636.65	11,715.22	101,921.43	3,119,879	368,002
Year ended 9-30-31		8,246.32	(8,246.32)		252,425
					.032668392
Balance 10- 1-31	113,636.65	19,961.54	93,675.11	2,867.454	620,427
Year ended 9-30-32	868.55	7,059.85	(6,191.30)		214,121
					.032971291
Balance 10- 1-32	114,505.20	27,021.39	87,483.81	2,653.333	834,548
Year ended 9-30-33	(134.10)	6,181.56	(6,315.66)		187,771
					.032920749
Balance 10- 1-33	114,371.10	33,202.95	81,168.15	2,465,562	1,022,319
Year ended 9-30-34	—	3,726.50	(3,726.50)		113,196
					.032920749
Balance 10- 1-34	114,371.10	36,929.45	77,441.65	2,352,366	1,135,515
Year ended 9-30-35	—	2,579.51	(2,579.51)		78,355
					.032920749
Balance 10- 1-35	114,371.10	39,508.96	74,862.14	2,274,011	1,213,870

Year ended	9-30-36)					
Well No. 6)	(b) (8,184.24)	2,600.92	(10,785.16)		
Abandoned)					
106,186.86		42,109.88	64,076.98	2,185,308	88,703	.029321714
Less depreciation on						
Well No. 6 abandoned		4,049.47				
Balance	10- 1-36	106,186.86	38,060.41	68,126.45	2,185,308	1,302,573

Notes: (a) Unit cost per barrel for depreciation units is determined by dividing the undepreciated balance at the end of a given year for the property as a whole (before any depreciation for that year) by the total oil reserves for that year before eliminating the production for the year but including additions to or reductions from the oil reserves during the year for changes in estimated production. Estimated oil reserves and resulting unit cost per barrel are for the entire lease and the estimate is based upon the aggregate potential production of all wells and no separate determination of unit cost as to each separate well has been made.

(b) Original Cost 9,093.60
 Less 10% for estimated salvage value 909.36

Amount included for depreciation..... 8,184.24

(c) Net barrels after deduction of lessor's royalty interest.

[Endorsed]: U. S. B. T. A. Filed Mar. 25, 1942. [130]

Before the United States Board of Tax Appeals
Docket No. 105967

MOHAWK PETROLEUM COMPANY,
Petitioner,
vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent,

Docket No. 105968

ALFRED L. MARSTEN, JR.,
Petitioner,
vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Docket No. 105969

LEWIS A. MARSTEN,
Petitioner,
vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Docket No. 105970

EDWIN V. MCKENZIE,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent. [132]

Docket No. 105971

ESTATE OF ALFRED L. MARSTEN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

San Francisco, California,
March 25, 1942,

2:00 P.M.

Met pursuant to notice.

Before:

Hon. William W. Arnold,
Member.

Appearances:

Fred H. Brown, Esq.,
465 California Street,
San Francisco, California,
appearing for the Petitioners.

T. M. Mather, Esq.,
appearing for the Commissioner of Internal
Revenue,
Respondent. [133]

PROCEEDINGS

The Clerk: At the request of Mr. T. M. Mather we will take up Docket 105967, Mohawk Petroleum Company. He has a stipulation of facts to be presented in this proceeding.

Mr. Fred H. Brown, C.P.A., 465 California Street, San Francisco, California, appears for the Petitioners.

STATEMENT ON BEHALF OF RESPONDENT

Mr. Mather: If your Honor please, in this case, as well as the transferee cases that are associated with it, with respect to the transferor, Mohawk Petroleum Company, the parties have entered into a stipulation of facts.

The case presents one issue, that is, whether or not the Petitioner is entitled to abandonment losses on oil well equipment, being on the unit of production basis for depreciation, and the wells that were abandoned being part of the tract.

All the facts with respect to that issue have been stipulated. We ask the stipulation be submitted and that the Board fix the time for filing briefs in the case.

If briefs are filed within 45 days they are to be filed concurrently. That is agreeable to the parties, I understand.

The Member: The depreciation has been on a par unit valuation?

Mr. Mather: It is on the unit of production basis [135] for depreciation. Depreciation is the only issue involved. No depletion is involved.

The Member: That is on the equipment?

Mr. Mather: Oil equipment.

Now in the transferee cases, in the petition in those cases the petition admits transferee liability, and I understand from counsel that if any deficiency is determined in the transferor case that the transferees admit liability for the amount of that addi-

tional deficiency together with interest as provided by law?

Is that correct?

Mr. Brown: That is correct.

The Member: Are these separate transferee cases?

Mr. Mather: Yes. The transferee cases are Alfred L. Marsten, Jr., Docket No. 105968; Lewis A. Marsten, 105969; Edwin V. McKenzie, 105970; and the Estate of Alfred L. Marsten, 105971.

The Member: Should the cases be consolidated?

Mr. Mather: I think probably so.

Mr. Brown: Yes.

The Member: Very well. The cases will be consolidated for briefing and report.

Your stipulation of facts covers all the cases?

Mr. Mather: No. The stipulation of facts only pertains to the transferor, the Mohawk Petroleum Company. [136] But if there is any deficiency determined against the transferor, Mohawk Petroleum Company, then these Petitioners, as transferees, admit their liability for the amount of that deficiency, together with interest as provided by law.

The Member: That is covered by your stipulation?

Mr. Mather: That is an oral stipulation. It is not included in the transferor's stipulation.

Mr. Brown: That is correct.

The Member: You speak for the Petitioners?

Mr. Brown: I speak for the Petitioners; yes, sir.

The Member: And the amount, if there is a deficiency, the full amount of the deficiency is assessable against each transferee?

Mr. Mather: That is correct, your Honor. There will be no question, as I understand it, about the payment of the tax if a deficiency is determined in the Mohawk Petroleum Company case. That tax will be paid. But these people who are the transferees, they have admitted that transferee liability in each of the petitions filed by the various transferees.

The Member: There is no question as to the amount received by them as being sufficient to cover it?

Mr. Brown: There is no question about that.

The Member: I want to get this straight. Very well, gentlemen. It will be so understood. [137]

The Clerk: Simultaneous briefs on May 9th.

The Member: Simultaneous briefs, gentlemen?

Mr. Brown: Yes.

Mr. Mather: Satisfactory.

The Member: Briefs to be filed concurrently on or before May 9th. Reply briefs on or before—

The Clerk: Thirty days—June 9th.

The Member: ——June 9th. Is that satisfactory, gentlemen?

Mr. Mather: Yes.

Mr. Brown: Yes.

The Member: Very well.

(Whereupon, at 2:10 P.M. hearing closed.)

[138]

United States Board of Tax Appeals

MOHAWK PETROLEUM COMPANY,

Petitioner, et al.¹

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Docket Nos. 105967, 105968, 105969, 105970, 105971
Promulgated October 30, 1942.

Petitioner, having consistently taken depreciation on oil well equipment on the unit of production method based on the estimated oil reserve of a lease and the cost of all equipment thereon, in the absence of a sale or showing of unusual conditions justifying earlier retirement, held not entitled to take a retirement loss on equipment used in connection with an abandoned well on the lease while the lease is producing from other wells located thereon.

Fred H. Brown, C. P. A., for the petitioners.

T. M. Mather, Esq., for the respondent.

OPINION

Arnold: These consolidated proceedings involve

¹Proceedings of the following petitioners are consolidated herewith: Alfred L. Marsten, Jr.; Lewis A. Marsten; Edwin V. McKenzie; and Estate of Alfred L. Marsten, Deceased, Edwin V. McKenzie, Executor.

deficiencies in income taxes determined by the respondent against petitioner Mohawk Petroleum Co. for the fiscal years ended September 30, 1936 and 1937, in the amounts of \$991.84 and \$15,603.44, respectively.

The petitioners in Docket Nos. 105968, 105969, 105970, and 105971 are admittedly transferees of the assets of the Mohawk Petroleum Co. and liable, as such transferees, for any deficiencies determined against the Mohawk Petroleum Co. herein, together with interest thereon as provided by law.

The question involved is whether the Mohawk Petroleum Co., hereinafter referred to as petitioner, is entitled to loss deductions in the amounts of \$5,044.13 and \$35,026.52 claimed to have been sustained by it through the abandonment of oil well equipment in the fiscal years ended September 30, 1936, and September 30, 1937, respectively.

The facts were stipulated.

The petitioner was in the taxable years a California corporation and filed its returns with the collector of internal revenue for the first district of California. The petitioner has consistently closed its books and filed its income tax returns on the basis of a fiscal year ending September 30.

[139]

The petitioner acquired certain oil and gas leases upon lands in the Fruitvale Oil Field in Kern County, California, shortly after its organization in 1928. One of the leases so acquired was called the Red Ribbon Ranch lease. At the time of the acquisition of this lease there was a producing oil

well located thereon. Five additional wells were drilled on the Red Ribbon Ranch lease by petitioner in 1929, 1930, and 1931 and all of the five wells became producing wells. All of the six wells located on the Red Ribbon Ranch lease continued to produce crude oil until during the fiscal year ended September 30, 1934, when one well became nonproductive. This well, petitioner's Red Ribbon Ranch lease well No. 6, was finally abandoned in the fiscal year ended September 30, 1936. The other five wells located on the Red Ribbon Ranch lease continued to produce crude oil for several years after the year ended September 30, 1936.

On December 12, 1932, the petitioner entered into an oil and gas lease with E. B. and Frona McKeehan covering certain lands in the Weedpatch Oil Field in Kern County, California. During the fiscal year ended September 30, 1934, two producing oil wells were drilled on the McKeehan lease and during the fiscal year ended September 30, 1936, one producing oil well was drilled thereon. During the fiscal year ended September 30, 1937, wells Nos. 1 and 3 on the McKeehan lease became nonproductive and were abandoned. Well No. 2 on such lease continued to produce for several years after the fiscal year ended September 30, 1937.

On March 17, 1936, the petitioner entered into an oil and gas lease with the Earl Fruit Co., a corporation, covering certain lands in Kern County, California. During the fiscal year ended September 30, 1936, one oil well was completed on the Earl Fruit

Co. lease and during the fiscal year ended September 30, 1937, two additional wells were completed on that lease. Earl Fruit Co. lease well No. 1 started production of crude oil in August 1936 and became nonproductive in May 1937 and was abandoned prior to September 30, 1937. Well No. 2 on the Earl Fruit Co. lease was completed in January 1937, but it was not a commercially productive well and was abandoned shortly after completion and the capitalized cost of the well was written off as a dry hole loss and allowed as such by the respondent in the fiscal year ended September 30, 1937. Earl Fruit Co. lease well No. 3 was completed in March 1937 and produced crude oil for several years after its completion. Two additional producing wells were later completed on this lease.

Ever since its organization in 1928 petitioner has consistently deducted intangible development costs in connection with drilling oil wells as expense and has capitalized the cost of tangible oil well equipment. The cost so capitalized of each well was set up sepa- [140] rately in the petitioner's books. The cost so capitalized applicable to the wells here in question is as follows:

Red Ribbon Ranch Lease Well No. 6.....	\$ 9,093.60
McKeehan Lease Well No. 1.....	22,304.17
McKeehan Lease Well No. 3.....	16,542.36
Earl Fruit Company Lease Well No. 1.....	15,735.91

Ever since its organization in 1928 petitioner has consistently computed depreciation on the so-called unit of production method, that is to say, the an-

nual depreciation applicable to the capitalized cost of oil well equipment located on a particular lease was determined by dividing the capitalized cost (after a 10 per cent reduction for estimated salvage value) of all the wells on a particular lease by the estimated net potential crude oil production of the lease and the unit cost per barrel thus determined was then multiplied by the net number of barrels produced during the year from that particular lease to arrive at the amount of depreciation for the year. Estimated oil reserves and resulting unit cost per barrel were for an entire lease and the estimate was based upon the aggregate potential production of all wells and no separate determination of unit cost as to each separate well was made.

The depreciation reserve account in the petitioner's general ledger relating to depreciation on the capitalized cost of its oil wells is segregated as between the depreciation applicable to each separate oil lease, but is not segregated as between each separate oil well located on a particular lease.

Ever since its organization in 1928 petitioner has maintained a record of the crude oil production of each separate oil well.

During the fiscal year ended September 30, 1936, petitioner wrote off as a loss consequent to the abandonment of its Red Ribbon well No. 6 in that year an amount of \$5,044.13, which said amount was computed as follows:

Total cost of tangible equipment capitalized..... \$9,093.60
 Less depreciation previously written off:

Year ended	Net Bbls. Produced after Royalty to Lessor— Red Ribbon Well No. 6	Unit Deprecn. Rate applicable to Red Ribbon Ranch Lease Well Equipment	Amount
Sept. 30, 1930	12,421	\$0.032668392	405.77
Sept. 30, 1931	22,876	.032668392	747.32
Sept. 30, 1932	41,285	.032971291	1,361.22
Sept. 30, 1933	37,847	.032920749	1,245.95
Sept. 30, 1934	8,785	.032920749	289.21
Sept. 30, 1935	None	.	None
Sept. 30, 1936	None		None
 Total			4,049.47
Abandonment Loss			5,044.13
			[141]

During the fiscal year ended September 30, 1937, petitioner wrote off as losses consequent to the abandonment of its McKeehan wells Nos. 1 and 3 and its Earl Fruit Co. well No. 1 a total amount of \$35,026.52, which amount was computed as follows:

Loss on McKeehan Well No. 1
 Total cost of tangible equipment capitalized..... \$22,304.17
 Less depreciation previously written off:

Year ended	Net Bbls. Produced after Royalty to Lessor— McKeehan Well No. 1	Unit Deprecn. Rate applicable to McKeehan Lease Well Equipment	Amount
Sept. 30, 1934	105,426	\$0.043556776	4,592.02
Sept. 30, 1935	114,161	.063458951	7,244.54
Sept. 30, 1936	40,122	.063458951	2,546.10
Sept. 30, 1937	8,300	.063458951	526.71
 Total			14,909.37
Loss on McKeehan Well No. 1			7,394.80

Loss on McKeehan Well No. 3			
Total cost of tangible equipment capitalized.....			16,542.36
Less salvage value of tangible equipment removed from well			1,479.75

Balance of equipment abandoned.....			15,062.61
Less depreciation previously written off:			

Year ended	Net Bbls. Produced after Royalty to Lessor— McKeehan Well No. 3	Unit Deprecn. Rate applicable to McKeehan Lease Well Equipment	Amount
Sept. 30, 1935	9,218	\$.063458951	584.96
Sept. 30, 1936	5,938	.063458951	376.92
Sept. 30, 1937	None		—

Total			961.88

Loss on McKeehan Well No. 3.....	14,100.73
Loss on Earl Fruit Company Well No. 1	
Total cost of tangible equipment capitalized.....	15,735.91
Less salvage value of tangible equipment removed from well	2,204.92

Balance	13,530.99
Depreciation previously written off.....	None

Petitioner did not adjust the cost of well equipment on account of depreciation in its computation of loss on the abandonment of the Earl Fruit Co. lease well No. 1 because at the time of closing its books for the fiscal year ended September 30, 1936, it had no reliable engineering reports as to the possible potential crude oil production from this lease and accordingly had insufficient data to compute depreciation with respect to the lease for the year and did not compute any depreciation in its books nor claim any depreciation in its income tax return with respect to the lease for the year. Respon-

[142]

dent computed and allowed depreciation applicable to the well equipment located on the Earl Fruit Co. lease for the year ended September 30, 1936, as follows:

	Total Cost of Tangible Eqpt.	Less estimated Salvage 10%	Balance subject to Deprecn.	*Unit Cost (Per Bbl.)	Net Production after Royalty to Lessor Bbls.	Deprecn.
Well No. 1.....	\$15,735.91	\$1,573.59	\$14,162.32	2,884.00		
Well No. 2.....	4,003.29	400.33	3,602.96	None		
Total	19,739.20	1,973.92	17,765.28	\$0.11188687	2,884.00	\$342.82

*Based on total net potential production (after deduction of royalty to lessor) of 149,453 barrels of crude oil.

In his final determination of tax for the fiscal year ended September 30, 1936, the respondent disallowed the claimed deduction of \$5,044.13 consequent to the abandonment of petitioner's Red Ribbon Ranch lease well No. 6 and similarly disallowed during the fiscal year ended September 30, 1937, claimed deductions totaling \$35,026.52 consequent to the abandonment of petitioner's McKeehan lease wells Nos. 1 and 3 and Earl Fruit Co. lease well No. 1, for the following reasons:

(b) On your return your claimed the deduction of \$5,044.13 in the fiscal year ended September 30, 1936 (and \$35,026.52 in the fiscal year ended September 30, 1937) as a loss sustained through abandonment of oil well equipment at oil wells shut down during the taxable year although other wells on the same leaseholds continued to operate.

You elected and have continued to deduct depreciation on your oil well equipment on your income tax returns on a unit of production basis based upon the total estimated production of oil to be obtained from an entire leasehold.

Since your tangible oil well equipment installations on each leasehold in question consist of more than one installation and depreciation has been based upon the average lives of all such installations, losses claimed on the normal retirements of such assets are not allowable inasmuch as an average rate contemplates a normal retirement of assets both before and after the average life has been reached and there is therefore, no possibility of as-

certaining any actual loss under such circumstances until all assets contained in the group have been retired or disposed of.

Therefore the losses claimed in the respective years are disallowed as deductions. See Article 23 (e)—3, Regulations 94 and 101.

Article 23 (e)—3 of Regulations 94 and 101, in so far as pertinent herein, is set forth in the margin.¹

[143]

(1) Art. 23 (e)—3. Loss of useful value.— * * *

If the depreciable assets of a taxpayer consist of more than one item and depreciation, whether in respect of items or groups of items, is based upon the average lives of such assets, losses claimed on the normal retirement of such assets are not allowable inasmuch as the use of an average rate contemplates a normal retirement of assets both before and after the average life has been reached and there is, therefore, no possibility of ascertaining any actual loss under such circumstances until all assets contained in the group have been retired. In order to account properly for such retirement the entire cost or other basis of assets retired, adjusted for salvage, will be charged to the depreciation reserve account, which will enable the full cost or other basis of the property to be recovered.

In cases in which depreciable property is disposed of due to causes other than exhaustion, wear and tear, and normal obsolescence, such as casualty, obsolescence other than normal, or sale, a deduction for the difference between the basis of the property (adjusted as provided in section 113 (b) and articles 113 (a) (14)—1, 113 (b)—1, 113 (b)—2, and 113 (b)—3) and its salvage value and/or amount realized upon its disposition may be allowed subject to the limitations provided in the Act upon deduction for losses, but only if it is clearly evident that

The petitioner contends that the unit of production method used by it in determining depreciation on its oil well equipment contemplated that the lives of the oil wells on a particular lease would be the same, i. e., as long as the lease on which such wells are located was commercially productive, and that the abandonment of any well and the retirement of its equipment prior to the time the lease becomes commercially nonproductive are premature and hence abnormal. The petitioner also contends that, since the method used by it was not based upon the average life of the individual well upon a given lease but upon the life of the lease, which is coextensive with the longest life of any well located on such lease, the losses claimed are allowable under the provisions of the last paragraph of article 23 (e)—3. (See note 1.)

The fallacy of petitioner's argument lies in the fact that it presupposes the life of the tangible equipment of a well to be coextensive with the life of the lease or so long as the lease on which the wells

such disposition was not contemplated in the rate of depreciation.

In the case of classified accounts, if it is the consistent practice of the taxpayer to base the rate of depreciation on the expected life of the longest lived asset contained in the account, or in the case of single item accounts if the rate of depreciation is based on the maximum expected life of the asset, a deduction for the basis of the asset (adjusted as provided in section 113 (b) and articles 113 (a) (14)—1, 113 (b)—1, 113 (b)—2, and 113 (b)—3) less its salvage value is allowable upon its retirement. * * *

are located is productive. It is common knowledge that some wells produce salt water and other deleterious substances that eat out the casing, tubing, rods, lead lines, and other equipment, necessitating replacements of tangible equipment during the productive life of such wells. On the other hand equipment in some wells may still have considerable useful life after a well becomes nonproductive. The fact that a well becomes nonproductive and is abandoned does not necessarily result in the complete loss of usefulness of the equipment thereon or accelerate its depreciation or constitute abnormal retirement of the equipment. Such equipment may be and often is used at other wells. The stipulation shows that the wells involved were abandoned, but there is no evidence showing that the equipment thereon was also abandoned because it had lost its usefulness or that the abandonment of the wells caused depreciation of the equipment in excess of that normally sustained. Except that the stipulation shows that petitioner "wrote off" the amounts of \$5,044.13 and \$35,026.52 "as losses consequent to the abandonment of its" wells and claimed losses on its income tax returns in such amounts, there is no evidence that the equipment was actually retired or abandoned because it had lost its economic usefulness and had no more than scrap or salvage value or no value.

The method used by petitioner contemplates the recovery of the entire cost of the equipment over the productive life of the lease. This method contemplates a normal retirement of the equipment,

both before and after the average life has been reached. In the absence of a sale of the equipment for which the loss is claimed, or unusual or abnormal circumstances which result in its destruction, obsolescence, or accelerated depreciation, no retirement loss is allowable so long as the lease continues to produce and other equipment on the same lease is in use.

What was said in U. S. Industrial Alcohol Co., 42 B. T. A. 1323, 1378-1379 (appeal pending, C. C. A., 2d Cir.), is equally applicable herein:

The principle to be applied to a composite rate in such a case as this, therefore, is that assets which are retired at the end of their normal life can not be permitted to furnish further compensation by way of a deduction for loss on retirement, even though they may be retired in advance of the average life of the entire group. Their early retirement will be compensated for by depreciation taken after the average period has passed.

What has been said, however, applies only to normal retirements; and the converse of the statement is also true. If assets are removed from the group as a result of abnormal retirements resulting from unanticipated causes occurring before the end of the normal life attributed to such assets in arriving at the composite rate, the resulting loss is the proper ground for a deduction. Such losses are not to be compensated for by way of depreciation. Southland Coal Co., 16 B. T. A. 50, and if not permitted as deductions will prevent the final recovery of the entire original cost.

It was stipulated that well No. 6, Red Ribbon Ranch lease, was abandoned in the year ended September 30, 1936, and that wells Nos. 1 and 3, McKeahan lease, and well No. 1, Earl Fruit Co. lease, were abandoned in the year ended September 30, 1937, for the reason that such wells became nonproductive and that the petitioner wrote off as losses the respective amounts herein claimed. It is not the well which is subject to depreciation, but it is the equipment used in connection with the production of oil which is the subject of depreciation. The life of the well does not determine the life of the equipment. There is no evidence that the equipment had outlived its usefulness or that the retirement of the equipment was necessitated by unusual or abnormal circumstances. The evidence shows that well No. 6 produced a total of 123,214 barrels of oil. This is less than the average estimated oil reserve of the Red Ribbon Ranch lease. Such a showing, however, does not entitle petitioner to the deduction of a retirement loss under the circumstances [145] shown herein. See *Acme Manifolding Co.*, 24 B. T. A. 429, and *U. S. Industrial Alcohol Co.*, *supra*.

The petitioner argues that it ought to be permitted to deduct the losses claimed because it kept records of the capitalized cost of equipment and the production of each well. However, in determining the depreciation allowable in years prior to the abandonment of the well for the purpose of computing the loss sustained the petitioner multiplied

the annual production by the rate used in determining the depreciation allowance on the lease on which the well was located. As heretofore stated, such rate was based on the estimated oil reserve of the entire lease and the capitalized cost of all the oil well equipment on such lease, less 10 percent for salvage. The evidence fails to show the estimated oil reserve for any of the wells abandoned. Not having the estimated oil reserve of the individual wells, it is impossible to determine the rate of depreciation applicable to the equipment of each well on the unit of production basis, even though the cost of the equipment and production of each well is shown.

Respondent in his determination allowed the loss claimed on well No. 2, Earl Fruit Co. lease, and there is no dispute as to that item. Well No. 1 on that lease produced oil, and although for a comparatively short time, under petitioner's unit of production method for determining depreciation on well equipment there is no reason why the equipment in connection with this well should be treated differently from that of wells abandoned on leases while other wells on the same lease continued to produce, since the Earl Fruit lease continued to produce after well No. 1 thereon was abandoned. The fact that petitioner had not determined the estimated oil reserve of such lease at the time of closing its books for the fiscal year ended September 30, 1936, and did not deduct any depreciation is immaterial. From the stipulation it appears that the oil reserve was

later determined and in computing petitioner's tax liability for the year ended September 30, 1936, the respondent allowed depreciation on the unit of production basis employed by petitioner.

The petitioner relies in particular upon the case of Witherspoon Oil Co., 34 B. T. A. 1130, claiming that the precise question here involved was presented therein. A reference to the record of that case discloses that the issues raised involved only an alleged partnership loss and disallowance of "undepleted cost." The Board approved the action of the respondent as to these two issues. The decision entered therein was for the amounts of the deficiencies in taxes claimed by the respondent, no allowance being made upon recomputation of the deficiency under Rule 50 for any undepreciated costs of physical assets. Apparently the depreciation deductions allowed by the respondent in that case were not questioned.

Decisions will be entered for the respondent.

(Seal of the Tax Court of the United States.) [146]

The Tax Court of the United States
Washington

(Seal)

Docket No. 105967

MOHAWK PETROLEUM COMPANY,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DECISION

Pursuant to the determination of the Board, as set forth in its Opinion, promulgated October 30, 1942, it is

Ordered and Decided: That there are deficiencies in income tax for the fiscal years ended September 30, 1936 and 1937 in the respective amounts of \$991.84 and \$15,603.44.

Enter:

(Signed) WILLIAM W. ARNOLD
Judge

Entered Nov. 4, 1942 [147]

The Tax Court of the United States
Washington
(Seal)

Docket No. 105968

ALFRED L. MARSTEN, JR.,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DECISION

Pursuant to the determination of the Board, as set forth in its Opinion, promulgated October 30, 1942, it is

Ordered and Decided: That there is a liability at law and in equity on the part of this petitioner for income tax for the fiscal years ended September 30, 1936 and 1937, in the amounts of \$991.84 and \$15,603.44, respectively, together with interest thereon as provided by law, as transferee of the Mohawk Petroleum Company.

Enter:

(Signed) WILLIAM W. ARNOLD
Judge

Entered Nov. 4, 1942. [148]

The Tax Court of the United States
Washington

(Seal)

Docket No. 105969

LEWIS A. MARSTEN,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DECISION

Pursuant to the determination of the Board, as set forth in its Opinion, promulgated October 30, 1942, it is

Ordered and Decided: That there is a liability at law and in equity on the part of this petitioner for income tax for the fiscal years ended September 30, 1936 and 1937 in the amounts of \$991.84 and \$15,603.44, respectively, together with interest thereon as provided by law, as transferee of the Mohawk Petroleum Company.

Enter:

(Signed) WILLIAM W. ARNOLD
Judge

Entered Nov. 4, 1942. [149]

The Tax Court of the United States
Washington

(Seal)

Docket No. 105970

EDWIN V. MCKENZIE,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DECISION

Pursuant to the determination of the Board, as set forth in its Opinion, promulgated October 30, 1942, it is

Ordered and Decided: That there is a liability at law and in equity on the part of this petitioner for income tax for the fiscal years ended September 30, 1936 and 1937 in the amounts of \$991.84 and \$15,603.44, respectively, together with interest thereon as provided by law, as transferee of the Mohawk Petroleum Company.

Enter:

(Signed) WILLIAM W. ARNOLD
Judge

Entered Nov 4, 1942. [150]

The Tax Court of the United States
Washington

(Seal)

Docket No. 105971.

ESTATE OF ALFRED L. MARSTEN, Deceased,
EDWIN V. MCKENZIE, Executor,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DECISION

Pursuant to the determination of the Board, as set forth in its Opinion, promulgated October 30, 1942, it is

Ordered and Decided: That there is a liability at law and in equity on the part of this petitioner for income tax for the fiscal years ended September 30, 1936 and 1937 in the amounts of \$991.84 and \$15,603.44, respectively, together with interest thereon as provided by law, as transferee of the Mohawk Petroleum Company.

Enter:

(Signed) WILLIAM W. ARNOLD
Judge

Entered Nov. 4, 1942. [151]

United States Board of Tax Appeals
(Now designated
"The Tax Court of the United States")

Docket No. 105967

MOHAWK PETROLEUM COMPANY,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Docket No. 105968

ALFRED L. MARSTEN, JR.,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Docket No. 105969

LEWIS A. MARSTEN,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Docket No. 105970

EDWIN V. MCKENZIE,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

[152]

Docket No. 105971

ESTATE OF ALFRED L. MARSTEN, Deceased,

EDWIN V. MCKENZIE, Executor,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

[153]

PETITION FOR REVIEW AND
ASSIGNMENTS OF ERRORTo The Honorable Judges of The United States
Circuit Court of Appeals for the Ninth Circuit:

The petitioners in this cause, Mohawk Petroleum Company, a California corporation, Edwin V. McKenzie as Executor of the Estate of Alfred L. Marsten, Deceased, Edwin V. McKenzie, an individual, Alfred L. Marsten, Jr., an individual, and Lewis A. Marsten an individual, by their attorneys, Edwin V. McKenzie and Jacob H. Sapiro, hereby file their petition for a review by the United States Circuit Court of Appeals for the Ninth Circuit, of the de-

cision by the United States Board of Tax Appeals, rendered on November 4, 1942 (47 B.T.A.-130) in the case of Mohawk Petroleum Company against Commissioner of Internal Revenue, Docket No. 105967, Alfred L. Marsten, Jr. against Commissioner of Internal Revenue, Docket No. 105968, Lewis A. Marsten against Commissioner of Internal Revenue, Docket No. 105969, Edwin V. McKenzie against Commissioner of Internal Revenue, Docket No. 105970, and Estate of Alfred L. Marsten, Deceased, against Commissioner of Internal Revenue, Docket No. 105971, which were consolidated for hearing and decision, and which determined deficiencies in the petitioner Mohawk Petroleum Company's Federal income taxes and undistributed profits for the fiscal [154] year ended September 30, 1936 in amount of \$991.84, and for the fiscal year ended September 30, 1937 in amount of \$15,603.44, and respectfully show:

I.

That petitioner, Mohawk Petroleum Company, is, and at all times mentioned herein was, a corporation duly organized and existing under and by virtue of the laws of the State of California, with its principal office at San Francisco, California; that petitioner, Edwin V. McKenzie, as Executor of the Estate of Alfred L. Marsten, is the duly appointed, qualified and acting Executor of the Estate of Alfred L. Marsten, Deceased, and at the time of his death a resident and inhabitant of San Francisco,

California; said decedent died, testate, on March 4, 1937. His will was admitted to probate in the Superior Court of the State of California, in and for the City and County of San Francisco, on March 19, 1937, on which said date said Edwin V. McKenzie then and there became, and ever since has been, and now is, Executor of said will and estate.

That the petitioners, Alfred L. Marsten, Jr., Lewis A. Marsten, Edwin V. McKenzie, are, and each of them is, an individual; all petitioners reside in and are inhabitants of San Francisco, California. The returns for the periods here involved were filed by each of said petitioners with the Collector of Internal Revenue for the First District of California. [155]

Petitioner, Alfred L. Marsten, Jr., is the owner of 3600 shares, petitioner Lewis A. Marsten is the owner of 3600 shares, petitioner Edwin V. McKenzie is the owner of 1,000 shares, and petitioner Edwin V. McKenzie as Executor of the Estate of Alfred L. Marsten, Deceased, is the owner of 52,300 shares of the capital stock of Mohawk Petroleum Company. The said Company distributed all of its assets to its stockholders prior to October 4, 1940. Each of the petitioners except Mohawk Petroleum Company received a portion of the assets of said Mohawk Petroleum Company as a liquidating dividend. Other than Mohawk Petroleum Company, each of the petitioners admits that he is a transferee of the assets of the said Mohawk Petroleum Company.

II.

The nature of the controversy is as follows:

The controversy involves the proper determination of the liability of petitioner, Mohawk Petroleum Company, for Federal income and undistributed profit taxes for the fiscal years ended September 30, 1936 and September 30, 1937. The notice of deficiency was mailed to said petitioners on October 4, 1940. The deficiencies asserted and set forth therein are \$991.84 for the fiscal year ended September 30, 1936, and \$15,603.44 for the fiscal year ended September 30, 1937, and a total of \$16,595.28.

The petitioners other than Mohawk Petroleum Company, in [156] dockets No. 105968, No. 105969, No. 105970, and No. 105971, are admittedly transferees of the assets of Mohawk Petroleum Company and liable, as such transferees, for any deficiencies determined against Mohawk Petroleum Company herein, together with interest thereon, as provided by law. Hereinafter, reference will be made to Mohawk Petroleum Company as petitioner.

The petitioner has consistently closed its books and filed its income tax returns on the basis of a fiscal year ending September 30th. During the said tax years of 1936 and 1937, petitioner abandoned four oil wells which had been capitalized on its books as follows:

Red Ribbon Ranch Lease, Well #6.....	\$ 9,093.60
McKeehan Lease, " #1.....	22,304.17
McKeehan Lease, " #3.....	16,542.36
Earl Fruit Co. Lease, " #1.....	15,735.91

All of these wells are situated in Kern County, California. In each of the three leases involved, other wells continued to produce after the several above-referred-to abandonments. The detail of these leases and wells is set forth in the stipulation of facts presented to the United States Board of Tax Appeals, which is part of the records herein.

Ever since the organization of petitioner in 1928, it has consistently deducted intangible development costs in connection with drilling oil wells as expense, and has capitalized the cost of tangible oil well equipment. The cost so capitalized of each well was set up separately in petitioner's books and in accordance with the above list. [157]

Ever since its organization the petitioner has depreciated the tangible well equipment connected with the wells on each lease on the "unit of production" method, such method being applied in such manner and with such records that the amount of depreciation taken with each well was determinable. Depreciation for each lease was determined (after a ten per cent reduction for salvage value) annually, by multiplying (1) the depreciation rate by (2) the barrels of oil produced by the several wells on the lease. A separate depreciation reserve account was kept for the depreciation relating to each lease. Ever since its organization petitioner maintained records of the barrels of oil produced by each well. Therefore it was immaterial whether depreciation was computed (1) by multiplying the production of each well by the rate and aggregating

the depreciation thus computed as to each well, or (2) by multiplying the aggregate production of all wells by the rate. From either method the same total of depreciation results. That part of the total depreciation, developed by the second method, applicable to either or any of the wells is determinable at any time by mere arithmetical calculation and with the same certainty as if the first method had been followed.

The petitioner abandoned the equipment connected with the certain wells here involved contemporaneously with the abandonment of the wells of which the equipment was an integral part.

During the fiscal year ended September 30, 1936, petitioner wrote off a loss consequent to the abandonment of [158] Red Ribbon Well #6 in that year in the amount of \$5,044.13. The detail of that computation is set forth in the agreed Statement of Facts before the United States Board of Tax Appeals.

During the fiscal year ended September 30, 1937, petitioner wrote off as losses consequent to the abandonment of the other three wells as follows:

McKeehan Well #1.....	\$ 7,394.80
McKeehan Well #2.....	14,173.00
Earl Fruit Co. Well #1.....	13,530.99
Total	\$35,026.52

In his final determination of tax for the fiscal year ended September 30, 1936, the respondent disallowed the foregoing items for the following reasons:

“(b) On your return you claimed the deduction of \$5,044.13 in the fiscal year ended September 30, 1936 (and \$35,026.52 in the fiscal year ended September 30, 1937) as a loss sustained through the abandonment of oil well equipment at oil wells shut down during the taxable year although other wells on the same leaseholds continued to operate.

You elected and have continued to deduct depreciation on your oil well equipment on your income tax returns on a unit of production basis based upon the total estimated production of oil to be obtained from an entire leasehold.

Since your tangible oil well equipment installations on each leasehold in question consist of more than one installation and depreciation has been based upon the average lives of all such installations, losses claimed on the normal retirements of such assets are not allowable inasmuch as an average rate contemplates a normal retirement of assets both before and after the average life has been [159] reached and there is therefore, no possibility of ascertaining any actual loss under such circumstances until all assets contained in the group have been retired or disposed of.

Therefore the losses claimed in the respective years are disallowed as deductions. See Article 23 (e)-3, Regulations 94 and 101.”

That thereafter the petitioners herein duly filed a petition in the United States Board of Tax Appeals claiming a reduction of said deficiencies in the sum of approximately \$900.00 for the 1936 fiscal year,

and the sum of approximately \$9,000.00 for the 1937 fiscal year by virtue of the abandonment of the said wells, together with the well equipment therein.

That in due course the said appeal to the United States Board of Tax Appeals came on for hearing and was submitted upon agreed and stipulated facts. That thereafter the said Board entered its findings of fact, opinion and decision, in which it disallowed the said deductions claimed by the petitioners and determined the deficiencies for the fiscal years 1936 and 1937 as the same are fixed by the Commissioner of Internal Revenue. In its opinion the Board stated its reasons for its conclusions as follows:

1. That the method used by petitioner contemplates the recovery of the entire cost of the equipment over the productive life of the lease, and such method contemplates a normal retirement of the equipment both before and after the average life has been reached; that in the absence of a sale of the equipment or unusual or abnormal circumstances resulting in its destruction, [160] obsolescence, or accelerated depreciation, no retirement loss is allowable so long as the lease continues to produce, and other equipment on the same lease is in use.

2. That the stipulation of facts shows that the wells were abandoned but not that the equipment thereon was abandoned because it had lost its usefulness or that the abandonment of the wells caused depreciation of the equipment in excess of that nor-

mally sustained, nor that the equipment had outlived its usefulness nor that the retirement was necessitated by unusual or abnormal circumstances.

In due course, and on November 4, 1942, the said Board entered its decision pursuant to and in accordance with its said opinion.

III.

The petitioners, and each of them, being aggrieved by said opinion, decision and order of the United States Board of Tax Appeals, desires a review thereof, in accordance with the statutes in such case made and provided, by the United States Circuit Court of Appeals for the Ninth Circuit, within which circuit is located the office of the Collector of Internal Revenue wherein was filed the income tax returns of all of said petitioners for the years involved herein.

IV.

ASSIGNMENTS OF ERROR

The petitioners, and each of them, assign as error [161] the following acts and omissions of the Board of Tax Appeals:

(1) In the failure to allow as a deduction from petitioner Mohawk Petroleum Company's gross income for the fiscal year ended September 30, 1936, the depreciated value as capitalized on its books of the well equipment which was abandoned contemporaneously with the abandonment of Red Ribbon Ranch Lease Well No. 6, in the approximate sum of \$900.00;

(2) In the failure to allow as a deduction from petitioner Mohawk Petroleum Company's gross income for the fiscal year ended September 30, 1937, the depreciated value as capitalized on the books of the well equipment which was abandoned contemporaneously with the abandonment of McKeehan Lease Wells No. 1 and No. 3 and Earl Fruit Company Lease Well No. 1, in the approximate aggregate sum of \$9,000.00;

(3) In holding that physical equipment in oil wells on leased property where such equipment on each well is depreciated on the number of units (barrels of oil) that the entire lease is supposed to produce is the same as taking a "composite rate" of depreciation on all physical assets of the said petitioner;

(4) In holding, based on the assumption in Paragraph 3 herein, that because said petitioner is taking a composite rate of depreciation against any and all its assets it may not deduct in any one year a specific amount for abandonment of well equipment because abandonment is a normal incident of depreciation. [162]

(5) In holding that the depreciation rate allows for normal discards, or abandonment, and that no loss may be taken for them.

(6) In holding that any composite or average rate of depreciation necessarily includes all abandonments, however substantial in value; that a reserve for abandonments is included within such depreciation rate.

(7) In holding that the abandonment of an oil well and its equipment, however substantial its value, is an ordinary concomitant and corollary to depreciation and included within it; that the loss by abandonment is not such "an unusual or abnormal circumstance which results either in the destruction, obsolescence or accelerated depreciation".

(8) In holding that when an oil well is abandoned and its equipment is likewise abandoned, the latter is not necessarily abandoned because it has lost its usefulness, or that the abandonment of the well causes depreciation of the abandoned equipment in excess of the depreciation normally sustained.

(9) In holding that well equipment which is of that nature which requires abandonment when an oil well is abandoned has neither outlived its usefulness nor is occasioned by either unusual or abnormal circumstances.

(10) In the failure to hold that where well equipment is abandoned the remaining asset value is thereby reduced by the value of such abandoned equipment and there is only left the lessened value of the remaining equipment to thereafter depreciate. [163]

(11) In the failure to give effect to the statute law of the State of California, Act No. 4916, Statutes of 1915, Page 104, as amended; Statutes of 1931, page 1645, as amended; Statutes of 1929, page 924, as amended; Statutes of 1917, page 1586; 1919, page 1116; 1921, page 1724; 1929, page 923;

1931, page 1644; Vol. 2 General Laws of California (Deering's) page 2398, and specifically to Sections 3, 15 and 16 thereof, and regulations issued under and pursuant to its authority respecting the abandonment of oil wells and requiring that oil well casings be left in abandoned wells to prevent damage to petroleum and gas deposits from infiltrating water and to prevent damage to underground and surface water suitable for domestic and irrigating purposes.

(12) In the failure to give effect to Article 23 (m-18) of Regulations 94 of the United States Treasury Department, Bureau of Internal Revenue, issued under and pursuant to the Revenue Act of 1936, declaring that the depreciation of improvements in oil and gas wells is solely referable to depreciation and is not based in whole or in part on any reserve for the abandonment of any such equipment, the said regulations declaring the following principle:

“The amount deductible on this account (depreciation of improvements in the case of oil and gas wells) shall be such an amount based upon its cost or other basis equitably distributed over its useful life as will bring such property to its true salvage value when no longer useful for the purpose for which such property was acquired”. [164]

Wherefore, petitioners herein pray that this honorable Court may review said opinion, decision and order of the United States Board of Tax Ap-

peals, and reverse and set aside same; that a transcript of record be prepared in accordance with law and rules of this Court, and transmitted to the Clerk thereof for filing, and appropriate action be taken to the end that the manifest errors herein complained of may be reviewed and corrected by this Court.

Respectfully submitted,

JACOB H. SAPIRO

EDWIN V. MCKENZIE

Attorneys for all of said
petitioners.

1049 Mills Building

San Francisco, California.

(Duly verified.)

[Endorsed]: T.C.U.S. Filed Jan. 29, 1943. [165]

[Title of Board and Causes.]

NOTICE OF FILING PETITION FOR
REVIEW [167]

To Honorable J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, Washington, D. C.

You are hereby notified that the petitioners above named, to wit, Mohawk Petroleum Company, Alfred L. Marsten, Jr., Lewis A. Marsten, Edwin V. McKenzie, and Edwin V. McKenzie, Executor of the Estate of Alfred L. Marsten, Deceased, did on the 29th day of January, 1942, file with the Clerk of

the United States Board of Tax Appeals, now designated "The Tax Court of the United States", Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Ninth Circuit of the decision of the Board heretofore rendered in the above entitled proceeding. A copy of the petition for review and assignments of error as filed is hereto attached and served upon you.

Dated this 29th day of January, 1943.

EDWIN V. MCKENZIE

J. H. SAPIRO

Attorneys for petitioners.

1049 Mills Building,

San Francisco, California.

[168]

Service of the above and foregoing notice, together with a copy of the petition for review and assignments of error mentioned therein, is hereby acknowledged this 29th day of January, 1943.

(Signed) J. P. WENCHEL

Chief Counsel, Bureau of Internal Revenue.

[Endorsed]: T.C.U.S. Filed Jan. 29, 1943. [169]

[Title of Board and Causes.]

PRAECLYPE FOR RECORD [170]

To the Clerk of the United States Board of Tax Appeals (Now designated "The Tax Court of the United States"):

You will please prepare, transmit, and deliver to the Clerk of the United States Circuit Court of Appeals for the Ninth Circuit, copies duly certified as correct of the following documents and records in the above-entitled proceedings in connection with the petition for review by the said Circuit Court of Appeals for the Ninth Circuit, heretofore filed by Mohawk Petroleum Company, Alfred L. Marsten, Jr., Lewis A. Marsten, Edwin V. McKenzie, and Edwin V. McKenzie, executor of the Estate of Alfred L. Marsten, Deceased, petitioners in said proceeding:

- (1) Docket entries of the proceedings before the Board.
- (2) Pleadings before the Board.
 - (a) Petitions filed herein, together with annexed copy of deficiency letter.
 - (b) Answers filed herein.
- (3) Stipulation of facts filed March 25, 1942 at the hearing before the Board.
- (4) Report of proceedings had at hearing by Board March 25, 1942.
- (5) Findings of fact, opinion, orders and decision of the Board:
 - (a) Opinion promulgated and entered October 30, 1942; [171]

(b) Decisions entered November 4, 1942.

(6) Petition for review and assignments of error of petitioners, Mohawk Petroleum Company, Alfred L. Marsten, Jr., Lewis A. Marsten, Edwin V. McKenzie, and Edwin V. McKenzie, executor of the Estate of Alfred L. Marsten, Deceased, filed January 29th, 1943.

(7) Notice of filing petition for review addressed to Hon. J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, dated January 29th, 1943, together with acknowledgment of service endorsed thereon.

(8) This praecipe, together with proof of service.

JACOB H. SAPIRO
EDWIN V. MCKENZIE
Attorneys for Petitioners.

[Endorsed]: T.C.U.S. Filed Jan. 29, 1943. [172]

[Title of Board and Causes.]

NOTICE OF FILING PRAECIPE [173]

To: Honorable J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, Washington, D. C.

You are hereby notified that petitioners on review in the above entitled proceeding did on the 29th day of January, 1943, file with the Clerk of the United States Board of Tax Appeals (now designated "The Tax Court of the United States") a praecipe, a copy of which, as filed, is hereto attached and served upon you.

Dated this 29th day of January, 1943.

JACOB H. SAPIRO

EDWIN V. MCKENZIE

Attorneys for Petitioners.

Personal service of the foregoing notice, together with a copy of the praecipe mentioned therein, is hereby acknowledged this 29th day of January, 1943.

Agreed to.

(Signed) J. P. WENCHEL

Chief Counsel, Bureau of Internal Revenue.

Attorney for Respondent.

[Endorsed]: T.C.U.S. Filed Jan. 29, 1943. [174]

[Title of Board and Causes.]

CERTIFICATE OF CLERK

I, B. D. Gamble, clerk of The Tax Court of the United States, do hereby certify that the foregoing pages, 1 to 174, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Praecipe in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of The Tax Court of the United States, at Washington, in the District of Columbia, this 16th day of February, 1943.

[Seal]

B. D. GAMBLE

Clerk, The Tax Court of the
United States.

[Endorsed]: No. 10373. United States Circuit Court of Appeals for the Ninth Circuit. Mohawk Petroleum Company, a California corporation, Edwin V. McKenzie, as Executor of the Estate of Alfred L. Marsten, deceased, Edwin V. McKenzie, Alfred L. Marsten, Jr., and Lewis A. Marsten, Petitioners, vs. Commissioner of Internal Revenue, Respondent. Transcript of the Record. Upon Petition to Review Decisions of the Tax Court of the United States.

Filed February 23, 1943.

PAUL P. O'BRIEN,

Clerk of the United States Circuit Court of Appeals
for the Ninth Circuit.

In the United States Circuit Court of Appeals
For the Ninth Circuit

No. 10373

MOHAWK PETROLEUM COMPANY, ALFRED L. MARSTEN, JR., LEWIS A. MARSTEN, EDWIN V. McKENZIE, and ESTATE OF ALFRED L. MARSTEN, Deceased, EDWIN V. McKENZIE, Executor,
Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

STATEMENT OF POINTS AND DESIGNATION OF RECORD UNDER RULE 19

Pursuant to Rule 19, petitioners, Mohawk Petroleum Company, Alfred L. Marsten, Jr., Lewis A. Marsten, Edwin V. McKenzie, and Estate of Alfred L. Marsten, Deceased, Edwin V. McKenzie, Executor, submit herein their statement of the points on which they intend to rely in the above entitled action, and herein designate the portions of the record which they think necessary for the consideration of their petition to review the decision of the United States Board of Tax Appeals (now designated United States Tax Court), as follows:

1. Statement of Points: Said petitioners intend to rely on each and all of the points set forth in the Assignments of Error contained in their petition

for review, heretofore filed with the Clerk of the United States Board of Tax Appeals (now designated United States Tax Court), and, therefore, hereby adopt each and all of their said assignments of error as the points on which they intend to rely.

2. Said petitioners hereby refer to, and incorporate herein by reference, that certain "Stipulation Designating Portions of the Record to be Printed", dated February 13, 1943, and executed by counsel for the respective parties to the above entitled action, which said stipulation designates that certain portions of the record shall be printed, and petitioners hereby designate each and all of the documents and matters specified in said stipulation to be printed as the parts of the record which they deem material.

Dated: February 24, 1943.

Respectfully submitted,

EDWIN V. MCKENZIE

J. H. SAPIRO

Attorneys for Petitioners.

Copy mailed to attorney for Commissioner of Internal Revenue, Feb. 24, 1943.

[Endorsed]: Filed Mar. 1, 1943. Paul P. O'Brien, Clerk.

[Title of Circuit Court of Appeals and Cause.]

STIPULATION DESIGNATING PORTIONS
OF THE RECORD TO BE PRINTED

It Is Hereby Stipulated by and between the petitioners above named and the respondent above named, that the Clerk of the above entitled Court shall print portions of the record in the above-entitled action hereinafter designated to be printed, and shall omit those portions of the record herein-after designated to be omitted.

The following shall be printed:

(1) Docket entry of proceedings before the United States Board of Tax Appeals.

(2) The pleadings of the petitioner Mohawk Petroleum Company and the answers of the respondent to the five petitions.

(3) Stipulation of Facts filed March 25, 1942 in the hearing before the Board.

(4) Report of proceedings had at hearing by Board March 25, 1942.

(5) Opinion promulgated and entered October 30, 1942.

(6) Decisions of the United States Board of Tax Appeals entered November 4, 1942.

(7) Petition for Review and Assignments of Error of petitioners Mohawk Petroleum Company, Alfred L. Marsten, Jr., Lewis A. Marsten, Edwin V. McKenzie, and Estate of Alfred L. Marsten, Deceased, Edwin V. McKenzie, executor, filed January 29, 1943.

(8) Notice of filing petition for review addressed to the Hon. J. P. Wenchel, Chief Counsel for the Bureau of Internal Revenue, dated January 29, 1943, together with acknowledgment of service endorsed thereon.

(9) Praeclipe for record filed with the Clerk of the United States Board of Tax Appeals (now designated Tax Court of the United States) on January 29, 1943; and

(10) Certificate of Clerk of the United States Board of Tax Appeals (now designated as Tax Court of the United States) certifying to said record.

There shall not be printed the following portions of the record:

(A) The petition of Alfred L. Marsten, Jr. (Docket No. 105968), excepting Paragraph 1 thereof, appearing on Page 29 of the record, and Paragraph (5) (a) thereof, appearing on Page 30 of the record, which read as follows:

“(1) The petitioner is an individual and resides in the City and County of San Francisco, State of California. His business address is 405 Montgomery Street, San Francisco, California. The returns for the periods here involved were filed with the Collector of United States Internal Revenue for the First District of California.

“(5) The facts upon which the petitioner relies as the basis for his proceeding are as follows:

(a) The petitioner was the owner of 3,600 shares of stock of Mohawk Petroleum Company. The said company distributed all of its assets to its stockholders prior to October 4, 1940. The petitioner received a portion of the assets of the said Mohawk Petroleum Company as a liquidating dividend. The respondent asserts and petitioner admits that he is a transferee of the assets of said Mohawk Petroleum Company".

(B) The petition of Lewis A. Marsten (Docket No. 105969), excepting Paragraph 1 thereof, appearing on Page 52 of the record, and Paragraph (5) (a) thereof, appearing on Page 53 of the record, which read as follows:

"(1) The petitioner is an individual and resides in the City and County of San Francisco, State of California. His business address is 405 Montgomery Street, San Francisco, California. The returns for the periods here involved were filed with the Collector of United States Internal Revenue for the First District of California.

"(5) The facts upon which the petitioner relies as the basis for his proceeding are as follows:

(a) The petitioner was the owner of 3,600 shares of stock of Mohawk Petroleum Company. The said company distributed all of its assets to its stockholders prior to October 4, 1940. The petitioner received a portion of the

assets of said Mohawk Petroleum Company as a liquidating dividend. The respondent asserts and petitioner admits that he is a transferee of the assets of said Mohawk Petroleum Company”.

(C) The petition of Edwin V. McKenzie (Docket No. 105970), excepting Paragraph 1 thereof, appearing on Page 76 of the record, and Paragraph (5) (a) thereof, appearing on Page 77 of the record, which read as follows:

“(1) The petitioner is an individual and resides in the City and County of San Francisco, State of California. His business address is 1049 Mills Building, San Francisco, California. The returns for the periods here involved were filed with the Collector of United States Internal Revenue for the First District of California.

“(5) The facts upon which the petitioner relies as the basis for his proceeding are as follows:

(a) The petitioner was the owner of 1,000 shares of stock of Mohawk Petroleum Company. The said company distributed all of its assets to its stockholders prior to October 4, 1940. The petitioner received a portion of the assets of the said Mohawk Petroleum Company as a liquidating dividend. The respondent asserts and petitioner admits that he is a transferee of the assets of said Mohawk Petroleum Company”.

(D) The petition of the Estate of Alfred L. Marsten, Deceased, Edwin V. McKenzie, executor (Docket No. 105971), excepting Paragraph 1 thereof, appearing on Page 99 of the record, and Paragraph (5) (a) thereof, appearing on Page 100 of the record, which read as follows:

“(1) The petitioner is Edwin V. McKenzie as Executor of the Estate of Alfred L. Marsten, Deceased, and his address is 1049 Mills Building, San Francisco, California. The returns for the periods involved were filed with the Collector of United States Internal Revenue for the First District of California.

“(5) The facts upon which the petitioner relies as the basis for his proceeding are as follows:

(a) The petitioner was the owner of 52,300 shares of stock of Mohawk Petroleum Company. The said company distributed all of its assets to its stockholders prior to October 4, 1940. The petitioner received a portion of the assets of the said Mohawk Petroleum Company as a liquidating dividend. The respondent asserts and petitioner admits that he is a transferee of the assets of the said Mohawk Petroleum Company.”

It Is Further Stipulated that the printed petition of Mohawk Petroleum Company, together with the modifications and additions hereinabove set forth to be printed be deemed the petition of all the said five petitioners named in these proceedings.

Dated: February 13, 1943.

EDWIN V. MCKENZIE

J. H. SAPIRO

Attorneys for Petitioners

SAMUEL O. CLARK, JR.,

Assistant Attorney General,

Attorney for Respondent.

[Endorsed]: Filed Mar. 1, 1942. Paul P.
O'Brien, Clerk.

